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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter II. SECTOR STRUCTURE AND REGULATION*

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LEGISLATIVE RECOMMENDATIONS

Market structure and competition

(1) In devising programmes to promote private sector investment in infrastructure development and operation, it is useful to review the assumptions under which State monopolies had been established, with a view to

(a) identifying the activities that still maintain the characteristics of natural monopoly and

(b) assessing the feasibility and desirability of introducing competition in other infrastructure sectors or segments thereof (see paras. 1-13).

Abolition of legal barriers and obstacles

(2) The opening of infrastructure sectors to private participation and competition requires the abolition of rules that prohibit private participation or new entry and the removal of other legal impediments to competition (see paras. 15-16).

Restructuring infrastructure sectors

(3) When formulating competition policies for individual infrastructure sectors, it is desirable to consider the possible need for, and the possible cost entailed by, separating the provision of infrastructure services from the operation of the underlying physical infrastructure (see paras. 18-21).

Transitional measures

(4) Where it is not advisable to introduce competition at once, the law may provide for temporary exclusivity rights, limitation in the number of concessionaires or other restrictions on competition. The scope and duration of such restrictions should normally be limited to the minimum required. The law may provide for periodic revisions of such restrictions with a view to ascertaining whether the conditions that justified them at the time when they were introduced still prevail (see paras. 33-34).

(5) Where the reform requires the restructuring or privatization of the incumbent public service provider, it is advisable to remove, restrict or shorten its exclusive rights or monopolies prior to the privatization (see para. 35).

Controlling residual monopolies

(6) Where the right to provide a specific service is restricted, it is advisable to award the pertinent licences or concessions through competitive selection procedures and to require that exclusive licences or concessions be rebid from time to time. The period between the

initial award and the subsequent rebidding should take into account the level of investment and other risks faced by the licensee or concessionaire (see paras. 37-38).

(7) Where economically and technically feasible, it may be useful to divide the territory of residual monopolies into smaller regions (see para. 40).

Conditions for the award of licences and concessions

(8) Where entry to the market is not restricted, the role of the licensing authority may be only to ascertain whether the new entrant meets the basic legal requirements to provide the services. Where the number of entrants is limited, it is advisable to use a competitive selection procedure for the award of the single or multiple licences offered (see paras. 50).

Interconnection and access regulation

(9) Service providers should have the right to use the infrastructure of the network operator on conditions that are not less favourable than those granted by the network operator to its own services or to competing providers (see paras. 51-54).

Price and profit regulation

(10) Where monopolistic conditions prevail or where markets are not yet truly competitive, it may be desirable to introduce a price or profit regulation mechanism (see paras. 55-56).

(11) Price regulation may be limited to non-competitive market segments, while leaving prices in competitive segments free. It may be useful to set only the broad pricing principles in legislation while leaving their actual implementation to the regulatory body concerned and the terms and conditions of licenses or concessions. It is advisable to provide a mechanism for revision of the tariff formula (see para. 57).

Subsidies and universal service

(12) Where service providers are required to offer specific services without compensation or below cost, it may be necessary to consider appropriate forms of direct compensation (see para. 62).

Performance standards

(13) Service providers should be required to meet technical and service standards, which should be provided in detail, as appropriate, in implementing decrees, concessions, licences or other documents (see para. 63).

Independence and autonomy of regulatory bodies

(14) It is advisable to consider separating the regulatory functions from operational ones by removing any regulatory functions that may still be vested with public service providers and entrust them to a legally and functionally independent body (see paras. 67-69).

(15) It is further advisable to consider granting the regulatory body a sufficient level of autonomy to ensure that its decisions are made on technical rather than political grounds (see paras. 70-71).

Sectoral attributions of regulatory bodies

(16) It is advisable to consider the possible advantages and disadvantages, including cost considerations, of organizing regulatory responsibilities on a sectoral or rather cross-sectoral basis (see paras. 72-73).

Mandate of regulatory bodies

(17) It is useful for the law setting up a regulatory mechanism to stipulate a number of general objectives that should guide the actions of regulatory bodies (e.g. the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability, the safeguarding of the public interest or of public service obligations, and the protection of investors' rights) (see para. 74).

Powers of regulatory bodies

(18) The law should set out with clarity whether the regulatory bodies have decision-making powers or purely advisory powers. The law should further specify which powers are vested with other governmental agencies and which ones with the regulatory body (see paras. 75-78).

Composition of the regulatory body

(19) Where the regulatory body takes the form of a regulatory commission, it may be advisable to keep the number of its members small (see para. 80).

(20) It may be useful to involve different institutions in the process leading to the nomination of the members of the regulatory commission and to require certain minimal professional qualifications, as well as the absence of conflicts of interest that might disqualify them for the function (see para. 81).

Disclosure requirements

(21) It may be desirable for the law to spell out certain specific obligations of public service providers, including the obligation to provide the regulatory body accurate and timely information on the operation of the company, and to grant the regulatory body specific

enforcement rights. They may include enquiries and audits, including detailed performance and compliance audits; sanctions for non-cooperative companies; power to issue orders or at least to initiate the issuance of orders; or penalty procedures to enforce disclosure (see paras. 84-86).

Procedures

(22) Legislation should require the publication of regulatory procedures, which should be objective and clear. Legislation should further require that regulatory decisions state the reasons on which they are based and be accessible to interested parties through publication or other means (see paras. 87-88).

(23) The regulatory process may include consultation procedures for major decisions or recommendations. To enhance transparency, comments or recommendations resulting from the consultation process may have to be published or made publicly available (see para. 89).

Sanctions

(24) The law may give the regulatory body adequate enforcement powers, including the power to modify a licence, concession or authorization, or to suspend it or withdraw it; the power to set the terms of contracts between public service providers (e.g. interconnection or access agreement); to initiate the break-up of a dominant public service provider; to issue orders to public service providers; to impose civil penalties including penalties for any delay in implementing the regulatory body's decision, and to initiate judicial proceedings (see para. 94).

Appeals

(25) It is advisable for the law to establish appeal procedures against decisions of a regulatory body. The law may limit the causes that give ground to appeals in order to prevent frivolous or dilatory appeals (see para. 95).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. Market structure and competition

1. In most of the countries that have recently built new infrastructure through private investment, privately financed infrastructure projects are not only an alternative for traditional financing of public infrastructure, but an important tool for meeting national infrastructure needs. Therefore, the conditions under which individual projects are executed have been typically devised in the light of the overall policy of the host Government for the infrastructure sector concerned. Essential elements of national policies include the level of competition sought for each infrastructure sector, the way in which the sector is structured and the mechanisms used to ensure adequate functioning of infrastructure markets.

2. National policies to promote private investment in infrastructure are often accompanied by measures destined to introduce competition between public service providers or to prevent abuse of monopolistic conditions, where competition is not feasible. Competition has been found to reduce costs and increase the productivity of infrastructure investment, as well as to enhance responsiveness to the needs of the customers. Through the lower costs and better quality obtained, competition typically improves the business environment in all sectors of the economy, thus increasing the country's competitiveness. Private participation has further been found to foster the development of modern management techniques and innovative solutions. Where it involves companies from other countries, it can make an important contribution to foreign direct investment and the international transfer of know-how.

1. Elements for the analysis of infrastructure markets

3. The scope for competition varies considerably in different infrastructure sectors. While certain sectors have been successfully opened to free competition, other sectors, or segments thereof, have the characteristics of natural monopolies, in which case open competition is usually not an economically viable alternative (see paras. 5-9). In order to analyse monopolistic conditions (including presence of a dominant position) and to determine the potential for competition, it is necessary to assess carefully the relevant market, taking into account, as appropriate, the degree to which some markets may be interrelated or segmemented. For instance, reforms in the power and gas sectors have in some countries been considered together in view of the significant degree of substitutability (and thus competition) between these two sources of energy. The same holds true for transport, where different modes often compete with each other; the relevant market may, for example, be the market for freight transport, including rail, road, water and air freight, as the case may be.

4. The measures that may be required to promote competition in various infrastructure sectors will essentially depend on the prevailing market structure (see paras. 22-32). Key elements that characterize a particular market structure include barriers to entry of competitors (e.g. economic, legal, technical or other), the degree of vertical or horizontal integration, the number of companies operating in the market as well as the availability of substitute products or services. Together, these elements determine the degree to which a market is competitive or not. Therefore, their analysis is crucial to develop strategies for policy intervention.

2. Competition policy and monopolies

5. In devising programmes to promote private sector investment in infrastructure development and operation, a number of Governments have found it useful to review the assumptions under which State monopolies had been established with a view to (a) identifying those activities that still maintain the characteristics of natural monopoly and (b) assessing the feasibility and desirability of introducing competition in certain infrastructure sectors.

6. The term monopoly in the strict sense refers to a market with only one supplier. However, pure monopoly and perfect competition mark two ends of a spectrum. Most markets for commodities or services are characterized by a degree of competition that lies between those two ends. Generally, monopolies can be classified as natural monopolies, legal monopolies and *de facto* monopolies; each of them may require different policy approaches:

(a) *Natural monopolies* are those economic activities that allow a single provider to supply the whole market at a lower cost than two or more providers. This situation is typical for economic activities that entail large investment and high fixed costs but decreasing costs of producing an additional unit of services (e.g. an additional cubic metre of water) to attend an increase of demand. Natural monopolies tend to exhibit large up-front fixed investment requirements which make it difficult for a new company, lacking comparable economies of scale, to enter the market and undercut the incumbent;

(b) *Legal monopolies* are established by law and may cover sectors or activities that are natural monopolies or not. In the latter category, monopolies exist solely because competition is prohibited. The developments that had led many countries to the establishment of legal monopolies were often based on the consideration that national infrastructure needs, both in terms of quality and quantity, could not be adequately met by leaving infrastructure to the free market;

(c) Lastly, *de facto monopolies* may not necessarily be the result of economic fundamentals nor of legal provisions but simply the absence of competition resulting, for example, from the integrated nature of the infrastructure company and its ability to control essential facilities to the exclusion of other suppliers.

7. From a policy perspective, monopolies (of whatever form) pose a variety of problems. A service provider operating under monopolistic conditions is typically able to fix prices. The surplus profit that results from insufficient competition is called a "monopoly rent". Monopoly rents may be perceived as being unfair, because they imply a transfer of wealth from consumers to producers. Furthermore, monopoly rents may be economically questionable, because they impose a net loss of welfare to the economy. This loss of welfare, which is sometimes called a "deadweight loss", is the result of three main reasons:

(a) Monopoly rents are obtained through inflated prices which result from artificially low production (static inefficiency);

(b) Lack of competition reduces the rate of innovation and efforts to reduce production costs (dynamic inefficiency); and

(c) Particularly in infrastructure sectors, there may be secondary effects on other markets (e.g. lack of competition and efficiency in telecommunications has negative repercussions on, or increases the costs for, the economy at large).

8. Despite their negative economic effects, monopolies and other regulatory barriers have sometimes been maintained in the absence of natural monopoly conditions. One of the reasons cited for retaining monopolies is that they may be used to foster certain policy objectives, such as ensuring the provision of services in certain regions or to certain categories of consumers at a low prices or even below cost. Examples of services for which the price may not cover costs include lifeline telephone, water or power service, discounted transport for certain categories of travellers (e.g. school children, senior citizens), as well as other services for low-income or rural users. A monopolistic service provider is able to finance the provision of such services through internal "cross-subsidies" from other profitable services provided in other regions or to other categories of consumers. However, the experience of a number of countries has shown that cross-subsidies may be costly and poorly targeted; furthermore, they are usually not transparent and bypass the normal budget allocation mechanisms allowing to fund expenditures that may otherwise not pass public scrutiny. Some countries have found that other policy instruments, including direct subsidies payable to the service provider, were better suited to ensure the provision of those services and did not rely on a continued monopoly situation.

9. Another reason sometimes cited for retaining legal monopolies in the absence of natural monopoly conditions is to make the sector more attractive to private investors. Private operators may insist on being granted exclusivity rights to provide a certain service so as to reduce the commercial risk of their investment. However, this objective has to be balanced against the interests of consumers and the economy as a whole. Alternative, and socially less costly, options to make the environment more attractive to investors include measures aimed at enhancing transparency and reducing uncertainty related to the regulatory regime. For those countries where the granting of exclusivity rights is found to be needed as an incentive to private investment, it may be advisable to consider restricting competition on a temporary basis only (see further chapter IV, "Conclusion and general terms of the project agreement", paras. 17-21).

3. Scope for competition in different sectors

10. Until recently, monopolistic conditions prevailed in most infrastructure sectors either because the sector was a natural monopoly or because regulatory barriers or other factors (e.g. vertically integrated structure of public service providers) prevented effective competition. However, rapid technological progress has challenged the economic fundamentals of many former natural monopolies. These changes have in many cases resulted in a gap between the economically desirable market structure and the legislation in force. This has prompted legislators in a number of countries to extend competition to infrastructure sectors by adopting legislation that abolishes monopolies and other barriers to entry, changes the way infrastructure sectors are organized and establishes a regulatory framework fostering effective competition. The extent to which this can be done depends on the sector, the size of the market and other factors.

11. In telecommunications, for instance, new telecommunications laws have been adopted in a number of countries largely as a result of the fast-changing technology in this sector. New wireless technology not only makes mobile telecommunications services possible, but is also

increasingly competing with fixed (wireline) services. Fibre optic networks, cable television networks, data transmission over power lines, global satellite systems, increasing computing power, improved data compression techniques, convergence between communications, broadcasting and data processing are further contributing to the breakdown of traditional monopolies and modes of service provision. As a result of these and other changes, telecommunications services have become competitive and countries are increasingly opening up this sector to free entry, while limiting access only to services that require the use of scarce public resources, such as radio frequency. In this context, market structure and competition rules need to be flexible enough to adapt to changing circumstances, which increasingly requires technologically neutral approaches.

12. In the energy sector, combined-cycle gas turbines and other technologies allowing for efficient power production on smaller scales and standardization in manufacturing of power generation equipment have led several countries to change the monopolistic and vertically integrated structure of domestic electricity markets. Increasing computing power and improved data processing software make it easier to dispatch electricity across a grid and to organize power pools and other mechanisms to access the network and trade in electricity. Like telecommunications, electricity is becoming a tradable commodity.

13. Technology is in many cases also at the origin of changing patterns in the transport sector: the introduction of containers and other innovations, such as satellite communications allowing to track shipments across the globe, have had profound consequences on shipping, port management, as well as rail and truck transport, while fostering the development of intermodal transport. This has led to faster, cheaper and more competitive transport modes and to the removal of transport sector monopolies that often prevailed.

B. Legislative measures to implement sectoral reform

14. Many countries have found that the introduction of private participation in infrastructure affords a unique opportunity to reconsider the existing market structure and regulatory setup. Legislative action typically begins with the abolition of rules that prohibit private participation in infrastructure and the removal of all other legal impediments to competition. Furthermore, where a decision has been made to open certain infrastructure sectors to competition, a number of countries have introduced changes in market structure or competition rules before, or in parallel with, the opening of the sector to private participation.1/

1/ See *World Development Report 1994. Infrastructure for Development*, World Bank, Washington, D.C., 1994, and in particular chapter 3 "Using markets in infrastructure provision" (pp. 52-72).

1. Abolition of legal barriers and obstacles

15. Monopolistic situations that are not, or have ceased to be, the result of economic and technological fundamentals, but of legal prohibitions, are the easiest targets for reform. Introduction of competition in these activities is relatively simple and may not require the restructuring of the incumbent monopolistic public service provider. The main action needed is the removal of the legal barriers, which may need to be reinforced by competition rules (such as the prohibition of collusion, cartels, predatory pricing or other unfair trading practices) and regulatory oversight (see paras. 41-95).

16. For a number of activities, however, effective competition may not be obtained through the mere removal of legislated barriers without legislative measures to restructure the sector concerned. In some countries, monopolies have been temporarily maintained only for the time needed to facilitate a gradual, more orderly and socially acceptable transition from a monopolistic to a competitive market structure.

2. Restructuring infrastructure sectors

17. Even in the absence of economic or legal barriers to entry, vertically or horizontally integrated infrastructure companies may be able to prevent effective competition. Integrated companies may try to extend their monopolistic powers in one market or market segment to other markets or segments in order to extract monopoly rents in these activities as well. Separating the monopoly element (such as the grid in many networks) from competitive elements in a sector may require the unbundling of vertically or horizontally integrated activities. Unbundling also facilitates the regulation of the residual and less complex monopolistic segments. It should be noted that many unbundling options have only recently become available to policy makers as a result of technological progress.

(a) Vertical and horizontal unbundling

18. Vertical unbundling occurs when upstream activities are separated from downstream ones, for example by separating production, transmission, distribution and supply activities in the power sector. The objective is typically to separate key network components or essential facilities from the competitive segments of the business.

19. Horizontal unbundling occurs when one or more parallel activities of a monopolist public service provider are divided among separate companies, which may either compete directly with each other in the market (as is increasingly the case with power production) or retain a monopoly over a smaller territory (as may be the case with power distribution). Horizontal unbundling refers both to a single activity or segment being broken up (as in the power sector examples) and to substitutes being organized separately in one or more markets (as in the case of separation of cellular services from fixed-line telephony, for example).

20. By and large, infrastructure services tend to be competitive, whereas the underlying physical infrastructure often has monopolistic characteristics. By separating the two, many countries have found to have been able to design new and more efficient sector solutions. Unbundling allows the introduction of competition in segments of the sector that are not natural

monopolies. The remaining monopolistic activities will either be exercised by a company (e.g. a power transmission or railtrack company) whose activities will need to be regulated because they include a monopolistic segment. Unbundling allows the State and the regulatory body to adopt different tools and approaches for activities that are competitive or a natural monopoly.

21. However, the costs and benefits of these changes need to be carefully considered. Costs may include the costs associated with the change itself (e.g. transaction and transition costs, including the loss incurred by companies which lose benefits or protected positions as a result of the new scheme) and the costs resulting from the operation of the new scheme, in particular higher coordination costs (e.g. more complicated network planning, technical standardization, as well as regulation). Benefits, on the other hand, may include new investments, better or new services, more choice, lower economic costs. Costs and benefits will also vary depending on how the changes are implemented.

(c) Recent experience in major infrastructure sectors

(i) Telecommunications

22. Unbundling has not been too common in the telecommunications sector. In some countries, long distance and international services were separated from local services; competition was introduced in the former, while the latter remained largely monopolistic. In some of these countries, this trend is now being reversed with local telephone companies being allowed to provide long-distance services and long-distance companies being allowed to provide local services, all in a competitive context. Mandatory open access rules are common in the telecommunications sector, where the historic public service provider typically provides services in competition with other providers while controlling essential parts of the network.

(ii) Electricity

23. Most new electricity laws call for the unbundling of the power sector by separating generation, transmission and distribution. In some cases, supply is further distinguished from distribution in order to leave only the monopolistic activity (i.e. the transport of electricity for public use over wires) under a monopoly. In these countries, the transmission and distribution companies do not buy or sell electricity but only transport it against a regulated fee. Trade in electricity occurs between producers or brokers on the one hand and users on the other. In some of these countries, competition is limited to large users only or is being phased in gradually.

24. Where countries have opted for the introduction of competition in the power and gas sectors, new legislation has organized the new market structure, stipulating to what extent the market had to be unbundled (sometimes including the number of public service providers to be created out of the incumbent monopoly), or removed barriers to new entry. The same energy laws have also established specific competition rules, whether structural (e.g. prohibition of cross-ownership between companies in different segments of the market, such as production, transmission and distribution, or gas and electricity sale and distribution) or behavioural (e.g. third party access rules, prohibition of alliances or other collusive arrangements). New institutions and regulatory mechanisms, such as power pools, dispatch mechanisms or energy

regulatory bodies, have been established to make these new energy markets work. Finally, other aspects of energy law and policy have had to be amended in conjunction with these changes, including the rules governing the markets for oil, gas, coal, and other energy sources.

(iii) Water and sanitation

25. The most common market structure reform introduced in the water and sanitation sector is horizontal unbundling. Some countries have created several water utilities where a single one existed before. This is particularly common in, but is not limited to, countries with separate networks that are not or are little interconnected. One of the advantages of such unbundling is to facilitate comparing the performance of service providers.

26. Some countries have invited private investors to provide bulk water to a utility or to build and operate water treatment or desalination plants, for example. In this vertical unbundling, the private services (and the discrete investments they require) are usually rendered under contract to a utility and do not fundamentally modify the monopolistic nature of the market structure: the plants usually do not compete with each other and are usually not allowed to bypass the utility to supply customers. This is a matter of design, however, and in a few countries these services are provided in a competitive context. A number of countries have introduced competition in bulk water supply and transportation; in some cases, there are active water markets. Elsewhere, competition is limited to expensive bottled or trucked water and private wells.

27. The solid waste sector can be divided into different segments including collection, transfer stations, transport, landfill, incinerator or other disposal scheme, and recycling. Again, by unbundling these separable activities, Governments have been able to introduce competition in the sector. The size of the market will be a key parameter in determining whether competition can be introduced and the extent to which unbundling makes sense.

(iv) Transport

28. Increasingly, the distinction is made between transport infrastructure and transport services. The former may often have natural monopoly characteristics, whereas services are generally competitive. Competition in transport services should be considered not only within a single mode but also across modes, as trains, trucks, buses, airlines and ships tend to compete for passengers and freight.

29. With respect to railways, some countries have opted for a separation between the ownership and operation of infrastructure (e.g. tracks, signalling systems, train stations) on the one hand and of rail transport services (e.g. passenger, freight) on the other. In these schemes, the law does not allow the track operator to operate also transport services, which are operated by other companies often in competition with each other. Other countries have let integrated companies operate infrastructure as well as services but have enforced third party access rights to the infrastructure, sometimes called trackage rights. In these cases, transport companies, whether another rail line or a transport service company, have the right to access the track on certain terms, and the company controlling the track has the obligation to grant such access. Barriers to investment and operation in this sector are also gradually being removed.

30. In many countries, ports were until recently managed as public sector monopolies. When opening this sector to private participation, legislators have considered different models. Under the landlord-port system, the port authority is responsible for the infrastructure as well as overall coordination of port activities; it does not, however, provide services to ships or merchandise. In service ports, the same entity is responsible for infrastructure and services. Competition between service providers (e.g. tugboats, stevedoring, warehousing) may be easier to establish and maintain under the landlord system. In addition to competition between service providers using common facilities or between competing facilities within a port, there may be strong competition between ports. Indeed, hinterlands overlap and shippers often have a choice of ports. A second type of sector reform may thus consist in encouraging competition between ports, be it by breaking up national port authorities, by strengthening intermodal connections of weaker ports, or by other means. Many Governments have found that by fostering competition between ports and within ports, service quality improves and the need to regulate decreases.

31. Legislation governing airports may also require changes, whether to allow private investment or competition between airports or within airports. Links between airport operation and air traffic control may need to be carefully considered as well. Within airports, many countries have introduced competition in handling services, catering, and other services to planes, as well as in commercial passenger services such as retail shops, restaurants, parking and the like. In some countries, the construction and operation of a new terminal at an existing airport has been entrusted to a new operator, hence creating competition between terminals. In others, new airports have been built on a BOT basis and existing ones are transferred to private ownership. Finally, many countries have found that liberalization of air transport (airline routes) greatly contributes to the demand for airport services and hence to the financial viability of private airport projects.

3. Transitional measures

32. Whether sector reforms involve abolishing legal barriers to entry, unbundling of separable market segments, other measures, or a combination thereof, Governments have often paid great attention to the reform process. The transition from monopoly to market may need to be carefully managed. Political, social or other factors have led some countries to pursue a gradual or phased approach to implementation. As technology and other outside forces are constantly changing, some countries have adopted sector reforms that could be accelerated or adjusted to take these changing circumstances into account.

(a) Phasing out barriers to entry

33. Some countries have felt that competition should not be introduced at once. In such cases, legislation has provided for temporary exclusivity rights, limitation in the number of public service providers or other restrictions on competition. The scope and duration of such restrictions should normally be limited to the minimum required (typically less than the scope and duration of the licence or concession). The first is set to give the incumbent adequate time to prepare for competition, adjust tariffs, while the latter is intended to provide the public service provider adequate incentives for investment and service expansion. Some laws include provisions for the loss of all or part of these exclusivity rights or protection if the public service provider

does not comply with the requirements of its licence; an exclusivity on the provision of certain services may lapse, for instance, if the dominant public service provider does not effectively provide them. Other countries have included provisions calling for the periodic revision (at the time of tariff reviews, for example) of such restrictions with a view to ascertaining whether the conditions that justified them at the time when they were introduced still prevail.

34. Recent experience in the telecommunications sector offers examples for this type of transitional measures. A number of modern telecommunications laws in many countries allow for full competition in all or most segments of the market. Legislators have often chosen to manage the transition to an open telecommunications sector gradually by lowering or removing barriers to entry and competition over a period of time, typically between one and seven years. Countries that have opted for the gradual approach have often started with the liberalization of terminal equipment (e.g. telephone sets, computer modems, private exchanges), followed by the introduction of one or more competing providers in mobile services (e.g. cellular telephony, paging) and the liberalization of value-added services (e.g. electronic mail, electronic databases, voice mail). After some years, long-distance and international services are opened up before local services and the sector as a whole including both infrastructure and services are liberalized. The advantage of this approach is to give incumbent public service providers the time to adjust to the new competitive context and, in particular, to adjust their tariffs in order to eliminate existing cross-subsidies between services. Some countries have pursued the same objective through other means, such as by gradually reducing high initial interconnection charges to cost-based levels as cross-subsidies are eliminated. The costs of a transition period include the delay in the benefits from competition accruing to users and, possibly, the weakening of the protected domestic public service providers relative to their foreign competitors operating in liberalized environments. In this sense, early reformers may have had more time to manage the transition to competitive markets than late reformers.

(b) Restructuring and privatization

35. Another transitional measure, at least in countries with state-owned public service providers, has been the restructuring or privatization of the incumbent service provider. All the reforms involving vertical and horizontal unbundling have by their nature required the restructuring of the incumbent public service provider. In addition, privatization of the State-owned public service provider has often been considered necessary to allow that company to compete effectively and fairly with new private entrants. While the sequence between privatization and liberalization has differed, liberalization has by and large either accompanied or preceded privatization. Some countries have proceeded otherwise and have privatized companies with significant exclusivity rights, often to increase privatization proceeds. They have, however, found it difficult and sometimes very expensive to remove, restrict or shorten at a later stage the exclusive rights or monopolies protecting private or privatized incumbents.

4. Controlling residual monopolies

36. Where natural monopoly conditions prevail and competition cannot be introduced *in* the market (that is, between companies competing for the same customers), many countries have introduced competition *for* the market (see paras. 37-39). Indirect competition between companies has also been created by way of benchmarks (see para. 40). In some cases, the Government may not be able to abolish legal barriers, to unbundle integrated sectors or to take other measures leading to the establishment of a competitive sector. In such cases, competition for the market and indirect competition may also be used to attenuate monopoly costs.

(a) Use of competitive selection procedures

37. Competition for the market refers to a process leading to the selection of a company among several competing consortia to be awarded the right to provide the infrastructure service (for a discussion of selection methods, see chapter III, "Selection of the concessionaire"). It provides a mechanism to reduce or eliminate monopoly rents by inviting competing companies to bid against each other for this right. It requires private participation though not necessarily at the exclusion of public sector candidates. Some local governments have, for example, awarded solid waste collection franchises or concessions to the incumbent public authority or successors thereof who won tenders in which they competed with private tenderers; in these cases, the actual threat of private entry resulted in significant improvements in public sector performance.

38. A number of countries have adopted legislation requiring that exclusive licences or concessions be rebid from time to time (see below, chapter X "Duration, extension and early termination", ___). The period between the initial award and the first (and subsequent) rebidding should take into account the level of investments and other risks faced by the investor. For solid waste collection licences not requiring heavy fixed investments the periodicity may be relatively short (e.g. every three to five years) whereas longer periods may be desirable for a power or water distribution contract, for example. In many countries, rebidding coincides with the end of the contract term, but in others a concession may be granted for a long period (e.g. ninety-nine years), with periodic rebidding (e.g. every ten or fifteen years). In the latter mechanism, which has been adopted in a few countries, the first rebidding occurs before the investor has fully recouped its investments; the incumbent has property rights that will need to be compensated if it does not win the next bidding round, in which case all or part of the bidding proceeds revert to the incumbent. Periodic rebidding may give public service providers strong performance incentives. While it may increase the longer term risk faced by investors and lenders, it may also provide them a valuable exit option.

39. Competition for the market may be used not only when the market in question is a natural monopoly, but also where resource constraints (such as wavelength spectrum availability) or Government decisions are limiting the number of concessions or licences awarded, hence creating a "scarcity" rent. If the Government decides to issue only two or three cellular licences, for example, the same mechanisms will be used to select the licensee; in these cases, however, the licence would normally not include exclusivity or, if it does, it would only be a temporary one allowing the Government to issue other licences a few years later.

(b) Geographical division of residual monopolies

40. By way of unbundling, many Governments have created the conditions for indirect, or "benchmark" competition, where concessionaires do not compete on the same territory but regulatory bodies are able to compare the performance of different companies (each with a regional monopoly) and use this information in the exercise of their regulatory functions (see chapter VIII, "Operational phase", ___). In this way, a regulatory body with authority over several concessionaires in a given sector (some of which may be publicly owned and operated) may be in a better position to regulate them. More generally, regulatory bodies may be able to use international prices as benchmarks against which to judge the costs and performance of regulated companies. These domestic and international reference points may provide strong indirect performance incentives to companies in monopolistic sectors. In some instances, such benchmark prices have even been included in tariff formulae.

C. Regulation of infrastructure services

1. General remarks

41. Regulation involves several distinct elements, including substantive rules, procedures, instruments and institutions. The regulatory framework in a given country and sector - which defines the rights and obligations of service providers, consumers, regulatory bodies and the Government - results from the interplay of these elements. Depending on the country and its legal and political traditions, this framework may be established by treaties, constitution, laws, executive decrees, regulations, decisions of regulatory bodies, case law, licences, concessions or other contracts or instruments.

(a) Historical context

42. Regulation of infrastructure was in many countries introduced to contain abuses of monopolistic providers and cartels of public service providers trying to maximize their profits by reducing output and increasing prices above the economically and socially desirable level. Governments have taken various approaches to control these monopolistic tendencies. In many instances, the monopolistic infrastructure service provider was set up as (or later became, following nationalization) a public sector enterprise. State or municipal ownership was seen in itself as a guarantee against abuses and as a protection of consumer interests; regulation was in these cases exercised by way of public ownership. In other countries or sectors, the infrastructure provider was or remained a private company. To control its operations and prevent the exercise of monopolistic pricing and marketing strategies, Governments often set up general (e.g. anti-trust) and sector-specific regulatory mechanisms. The first regulatory commissions were set up in the mid nineteenth century.

43. The shift toward greater private participation and competition has been accompanied and strengthened by a shift to less intrusive regulation of public service providers (whether State owned or private entities). Realizing that short-term political pressures often led to barriers to entry and other regulatory interventions that were not always in the public interest, many Governments have limited their level of discretion (often in contractual terms) and have opted for autonomous and independent regulatory mechanisms less exposed to political pressures. Where

successfully introduced, these reforms have lowered the risks faced by private investors and hence financing costs.

(b) Objectives of regulation

44. The main purposes of regulation are to promote competition and efficiency, to address and correct to the extent possible market failures, and more generally to protect users from potential abuses by dominant or monopolistic public service providers and to protect investors from possible arbitrary government action. Regulatory intervention is often justified by a situation in which the market, left to its own devices, would not yield the desirable social outcome. Regulation may include control of monopoly power (including dominant positions), but also address environmental, safety, public health and other concerns. Those concerns are usually not specific to infrastructure sectors or to private companies, but are part of the overall regulatory framework that governs economic activity.

45. The nature of regulation differs substantially according to the characteristics of the sector. In natural monopolies, regulation focuses primarily on the production of the socially desirable level of services at economic prices, in particular by limiting the opportunities for the public service provider to collect monopoly rents. Where the sector as a whole is monopolistic, price control is often the key instrument. Where one or more segments of the sector are monopolistic and the rest competitive, special attention may need to be given to overseeing access by competitors to the monopolistic segments.

46. Another major factor is the degree to which market-based reforms have been or are being introduced. A change in market structure, the introduction of private participation or competition in infrastructure sectors generally require new rules and institutions. In sectors in transition to market-based competition, regulation focuses primarily on managing this transition by ensuring that competition is effectively introduced and promoted. Once a sector or segment has become competitive (as may be the case for telecommunications services in some countries), sector-specific regulation may give way to the general competition regime covering most sectors of the economy. The regulatory rules and institutions established by legislators typically take such factors into account. Flexibility is required to adapt to evolving conditions.

(c) Costs and benefits of regulation

47. Infrastructure regulation is a complex task requiring considerable resources. The process is relatively new for many countries and lessons can be drawn from the experience of those countries that have already implemented similar reforms.

48. However, it is important to weigh the costs and benefits of regulation. Effective regulation can foster the transition to competitive market, and protect consumers and investors, but it also has its costs. The direct costs of regulation include not only the costs of the regulatory machinery itself but also the costs of compliance by regulated enterprises. Indirect costs of regulation can be even more significant. Regulation may create distortions which at times may be larger than the market failures it was supposed to address. This may result from weak information available to regulatory bodies, capture of the regulatory process by interest groups,

dearth of professional qualifications and experience of the regulatory body (which may be caused at least in part by inadequate regulatory resources and funding), lack of flexibility in rules and procedures or ill-considered or obsolete substantive rules. Finally, as a sector moves toward a competitive market structure the need for specific regulation disappears.

2. Substantive rules

49. Regulatory interventions may be divided into two broad categories. The first category includes the various actions up to the award of licences or concessions; these include sector reform and legislation, and managing the selection process for the award of licences or concessions. The second category is the regulatory intervention following the award of such licences or concessions. The following paragraphs briefly discuss some of the main regulatory issues that are encountered in a similar context in different sectors, including the regulation of entry and exit of competitors, interconnection, prices (tariffs), subsidies and universal service, and quality and performance.

(a) Conditions for the award of licences and concessions

50. Entry and exit rules are at the core of the organization of infrastructure sectors. Rules may allow for free entry of service providers into a sector or segment thereof or may limit such entry to a number of providers as determined by government through a licensing or concession scheme. Where free entry is the rule, as is the case in an increasing number of countries for many telecommunications services or for power generation, the role of the licensing authority may be only to ascertain whether the new entrant meets the basic legal requirements to provide such services. In some countries, the new entrant simply has to file a declaration and may start services unless the licensing authority expresses an objection within a given time limit (for example, one month). Where the number of entrants is limited, Governments are often required by law to organize a competitive process for the award of the single or multiple licences offered (see further chapter III, "Selection of the concessionaire").

(b) Interconnection and access regulation

51. In network industries, such as railway transport, telecommunications, power or gas supply, the historic or dominant public service provider may try to protect or limit access by third parties to its network, which is often the monopolistic segment in these industries. In order to introduce competition, mandatory rules for access to the network by new entrants have been introduced as a key aspect of sector reform and regulation. In some cases, such rules have complemented the vertical unbundling measures (see paras. 18-21), in others they have been adopted to foster competition in sectors that remained fully or partially integrated.

52. Access rules generally impose obligations on the network operator to provide access on terms that are fair and non-discriminatory from a financial as well as technical point of view. Non-discrimination implies that the new entrant or service provider is able to use the infrastructure of the dominant public service provider on conditions that are not less favourable than those granted by the network operator to its own services or to those of competing providers. It should be noted, however, that, for example, many pipeline access regimes do not require completely equal terms for the carrier and rival users. The access obligation may be qualified in

some way: it may for instance be limited to spare capacity only or be subject to reasonable (rather than equal) terms and conditions.

53. Generally, regulatory bodies will wish to ensure that access prices are high enough to give adequate incentives to invest in maintenance and expansion of the required infrastructure and low enough to encourage competition in the sector. Access pricing is usually cost-based. Where the network company provides services in competition with other providers, this may require that its activities be separated from an accounting point of view in order to determine the actual cost of the use by third parties of the network or parts thereof.

54. Technical access conditions may be equally critical, and dominant public service providers may be required to adapt their network to satisfy the access requirements of new entrants. Access may be to the network as a whole or to monopolistic parts or segments of the network (sometimes also referred to as bottleneck or essential facilities). Many Governments allow service providers to build their own infrastructure or to use alternative infrastructure where available; in such cases, the service provider may only need access to a small part of the network and cannot, under many regulations, be forced to pay more than the cost corresponding to the use of the specific facility he needs; this could be, for instance, the local loop in telecommunications, transmission capacity for the supply of electricity, or the use of a track section in railways.

(c) Price and profit regulation

55. Rules governing infrastructure sectors in most countries include price or profit regulation. The economic rationale is that, where monopolistic conditions prevail or where markets are not yet truly competitive, dominant public service providers may price their services too high to earn excess profits or too low (on a temporary basis) to drive out new entrants (predatory pricing). High prices and inadequate competition in infrastructure services may have a detrimental impact on the sector concerned and also on the national economy.

56. Infrastructure sectors have different market structures and scope for unbundling and competition. Increasingly, countries limit price regulation to non-competitive market segments, while leaving prices in competitive segments free. For example, cellular telephony prices may in some countries be left unregulated while local phone tariffs may remain regulated. In countries where road transport (or water transport) provides adequate competition, prices of rail transport may similarly be left unregulated. Where a company provides price-regulated services as well as unregulated services, safeguards may need to be established to prevent the company from cross-subsidizing its competitive activities with revenues from its regulated activities; to facilitate the enforcement of the prohibition of cross-subsidization, typical safeguards include separate cost accounting or the establishment of one or more subsidiaries to house the competitive or potentially competitive activities. Furthermore, in many countries price ceilings apply only to the dominant public service providers (to keep in check their ability to abuse their dominant position) and not to new entrants.

57. Many countries have chosen to set only the broad pricing principles in legislation while leaving their actual implementation to the concerned regulatory body and the terms and conditions of licences or concessions. Others have chosen to legislate tariff formulae. By and large, a

balance is sought between the interests of users and those of investors and often also current and future users. For example, where tariffs are kept too low, public service providers are hurt, investors deterred and future users penalized as they will have to pay for postponed investments. The tariff regime will also require adequate stability and predictability, to enable public service providers and users to plan accordingly.

58. Many infrastructure projects require heavy capital investment with relatively long amortization periods. Tariff formulae cannot be set once and for all, as technology, exchange rates, wage levels, productivity and other factors are bound to change significantly (and often unpredictably) over such periods. Many countries have in place mechanisms for revision of tariff formulae. Periodic revisions (e.g. every four or five years) of the formula usually amount to a renegotiation of the contract, bearing in mind the interests of users and of the economy at large, as well as investors and lenders.

59. Legislators have opted for various price control systems, the most common being rate of return regulation and price cap regulation. Many tariff regimes have elements of both. Under rate of return regulation, infrastructure service providers are allowed a given return on their investments, usually expressed in percentage terms. Each year (or each time the regulatory body, the company or other interested parties deem that the prices in effect yield too much or too little profits) the regulatory body verifies the expenses of the utility, determines to what extent investments undertaken by the company are eligible for inclusion in the rate base, and calculates the revenues that need to be generated to cover the allowable expenses and the agreed-upon return on investment. Where available, regulatory bodies use risk-adjusted market rates to determine the rate of return figure. This system requires a substantial amount of information as well as negotiations (e.g. on eligible expenditures and cost allocation). It does not give public service providers strong incentives to improve efficiency as the efficiency gains they achieve in one year result in lower tariffs for the following year.

60. Under the price cap regime, a price formula is set for a given period (e.g. four or five years). Each year prices are allowed to fluctuate within the limits set by the formula. In some countries, the formula is a weighted average of various indices, in others it is a consumer price index minus a productivity factor. Where substantial new investments are required, the formula may include an additional component to cover these extra costs. The formula can apply to all services of the company or to selected baskets of services only, and different formulae may be used for different baskets. Services provided in a competitive environment may be excluded from the basket and deregulated, and the composition of the basket may be reviewed from time to time to take new market conditions into account. This price cap technique has been adopted increasingly in recent years. It may provide greater incentives for public service providers, as efficiency gains may be kept until the next adjustment period. In some countries, the price cap formula calls for partial pass-through of efficiency gains to consumers. The periodic readjustment of the formula is, however, based on rate-of-return type of calculations, requiring the same type of detailed information as indicated above, though on a less frequent basis.

61. Another price regulation technique that may be used to set prices, or more generally to monitor price levels, is benchmark or yardstick pricing. By comparing the prices of one public service provider with those of another and with international norms, regulatory bodies may be able to judge whether tariff adjustments requested by the public service provider are reasonable.

Whatever technique is chosen, the complexity of the tariff mechanism should not exceed the administrative capacity of those in charge of implementing, monitoring and adapting it.

(d) Subsidies and universal service

62. In many countries, the law requires that specific services must be provided even if they have to be provided without compensation or below cost. Examples of free services are emergency services (e.g. telephone calls to police, fire department, ambulances; inspection of alleged gas leaks or dangerous power lines). Services for which the price may not cover the costs include lifeline telephone, water or power service, discounted transport for certain categories of travellers (e.g. school children, senior citizens), as well as other services for low-income or rural users. Public service providers may recoup these service burdens or costs in several ways, including through Government subsidies, through funds or other official mechanisms created to share the financial burden of these obligations among all public service providers, or through internal cross-subsidies from other profitable services. Cross-subsidies should be distinguished from differentiated pricing, where different categories of users pay different prices (depending inter alia on the price elasticity of their demand), but where all prices cover, at least in the short run, marginal cost of the service. In this sense, price differentiation may be efficient and should not be prohibited. Direct Government or fund subsidies have the advantage of being more transparent and easier to monitor than cross-subsidies.

(e) Performance standards

63. Companies operating in regulated sectors generally have to meet a set of technical and service standards (see chapter IX, "Delays, defects and other failures to perform", ___). These are often too detailed to figure in the sector legislation and may be included in implementing decrees, concessions, licences or other documents. They include, for instance, minimum conditions to insure interconnection in networked sectors, quality standards (such as requirements with respect to water purity and pressure), ceilings on time to perform repairs, ceilings on number of faults or complaints, on-time performance for transport services, continuity in supply, as well as health, safety and environmental standards. Legislation may, however, impose the basic principles that will guide the drafting of detailed standards or require compliance with international standards.

3. Regulatory bodies

64. Legislative provisions governing regulation of infrastructure sectors generally include substantive as well as institutional rules. They are established by various bodies and are implemented and monitored by others. The term "regulatory bodies" refers to the institutional mechanisms required to implement and monitor the substantive rules.

65. Regulatory bodies are needed because in the area of the operation of infrastructure facilities it is generally necessary for the rules to allow for a degree of discretion; someone needs to apply or implement the substantive rules, interpret them, monitor compliance, impose sanctions, and settle disputes arising out of the implementation of the rules. The specific

regulatory tasks and the amount of discretion they involve will be determined by the rules in question, which can vary widely.

(a) Range of institutional set-ups

66. The range of institutional mechanisms for the regulation of infrastructure sectors varies greatly. While many countries still entrust regulatory functions to Government departments (such as the concerned ministries or departments in charge of prices or competition matters), the general trend is toward the establishment of autonomous regulatory bodies, separate from the Government. The same country may subject some infrastructure sectors to autonomous and independent regulation while leaving others under ministerial regulation. Regulatory powers may also be shared between an autonomous regulatory body and the Government, as is often the case with respect to licensing.

(b) Independence and autonomy of regulatory bodies

67. Regulatory bodies need to be isolated and protected from inappropriate pressures. Regulatory decisions need to be taken without interference from public service providers. To that effect, legislative provisions in most countries require the independence of the regulatory decision making process. Effective independence and autonomy go a long way towards reducing regulatory risks and hence reduce the cost of infrastructure services.

68. A primary requirement is the separation of regulatory functions from operational ones by removing any regulatory functions that may still be vested with the public service providers and entrust them to a legally and functionally independent entity. Examples of confusion between regulatory and operational functions may include the right of the incumbent public service provider to certify equipment for use on a network or to set interconnection or access conditions unilaterally, or the right of a port operator to allocate berths to incoming ships.

69. Another essential requirement is the total independence of regulatory bodies from the industry they are regulating. That independence is often underpinned by prohibitions for staff of the regulatory body to hold mandates, accept gifts, enter into contracts or have any other relationship (directly or through family members or other intermediaries) with regulated companies, their parents or affiliates. This independence is a condition for the credibility of the regulatory body. It also implies that, to avoid conflicts of interest, regulation should, in particular in countries and sectors in which state-owned enterprises operate, be free from interference from the Government and the owners of enterprises in the sector.

70. This leads to a related issue, namely the autonomy of the regulatory body relative to the Government. This autonomy may be needed to minimize the risk of decisions being made or influenced by a body that is also the owner of enterprises operating in the regulated sector, or a body acting on political rather than technical grounds.

71. Independence and autonomy should not be considered solely on the basis of the institutional position of the regulatory function, but also on the basis of its functional autonomy, which requires that regulatory bodies have the financial and human resources to discharge their responsibilities professionally and with integrity.

(c) Sectoral attributions of regulatory bodies

72. Regulatory responsibilities may be organized on a sectoral or cross-sectoral basis. Countries that have opted for a sectoral approach have in many cases decided to place closely linked sectors or segments thereof under the same regulatory umbrella, as may be the case for example for telecommunications, cable television and broadcasting; power and gas; airports and airlines; or, more generally, competing transport modes. Other countries have organized regulation on a cross-sectoral basis, in some cases with one regulatory entity for all infrastructure sectors, and in others with one entity for utilities (water, power, gas, telecommunications) and one for transport.

73. The decision to use one or another model depends in part on the country's regulatory capacity; the weaker it is, the more reason to reduce the number of independent structures and try to achieve economies of scope. Other reasons for having multi-sectoral agencies include: the common issues arising in the different infrastructure sectors and the ability to learn from the experience gained in other sectors; consistency in regulatory approach between sectors; the scope and sequence of the reform program (if it starts with one sector only, the entity will often be sector-specific); and better resistance to pressures from sectoral interest groups. One possible drawback of cross-sectoral bodies is that it may not foster the development of technical (i.e. sector-specific) expertise.

(d) Mandate of regulatory bodies

74. The law setting up a regulatory mechanism often stipulates a number of general objectives that should guide the actions of regulatory bodies, such as the promotion of competition, the protection of users' interests, the satisfaction of demand, the efficiency of the sector or the public service providers, their financial viability, the safeguarding of the public interest or of public service obligations, and the protection of investors' rights. Having one or two overriding objectives helps clarify the mandate of regulatory bodies and establish priorities among sometimes conflicting objectives. A clear mandate also increases a regulatory body's autonomy and credibility.

(e) Powers of regulatory bodies

75. Regulatory bodies may have decision-making powers, advisory powers or purely consultative powers or a combination of these different levels of powers depending on the subject matter. In some countries, the legislator has decided to give the regulatory body limited powers initially but has increased them later as the regulatory body established a track record of independence and professionalism. The legislation often specifies which powers are vested with the Government and which ones with a regulatory agency. Clarity in this respect is important to avoid unnecessary conflicts and confusion. Investors, as well as consumers and other interested parties, should know to whom to turn with various requests, applications or complaints.

76. Licensing of public service providers, for example, is in many countries a process involving the Government as well as the regulatory body. If the decision to award a project

involves broad judgment of a political rather than technical nature, which may often be the case in the context of infrastructure privatization, final responsibility often rests with the Government. If, however, the award criteria are more technical, as may be the case with a liberal licensing regime for power generation or telecommunications services, many countries entrust the decision to an independent regulatory body. In other cases, the Government may have to ask the regulatory body's opinion prior to issuing the licence. On the other hand, some countries exclude direct involvement of regulatory bodies in the licensing process on the basis that it could affect the way they later regulate the use of these licences.

77. The jurisdiction of regulatory bodies normally extends to all enterprises operating in the sectors they regulate, with no distinction between private and public enterprises. The use of some regulatory powers or instruments may be limited by law to the dominant public service providers in the sector; a regulatory body may, for example, have price policing powers only vis-à-vis the incumbent or dominant public service provider, while new entrants may be allowed to set prices freely.

78. The matters on which regulatory bodies have to pronounce themselves range from normative responsibilities (e.g. rules on the award of licences, conditions for certification of equipment), to the award of licences, concessions or authorizations; the modification of such instruments; the approval of contracts or decisions proposed by the regulated entities (e.g. a schedule or contract on network access); the definition and monitoring of an obligation to provide certain services; the oversight over public service providers (in particular compliance with licence conditions, norms, performance targets); tariff setting or adjustments; vetting of subsidies, exemptions or other advantages that could distort competition in the sector; sanctions; and dispute settlement.

(f) Composition of regulatory bodies and their staff

79. The confidence of investors and the public in the professionalism, competence, efficiency and integrity of the regulatory function depends to a large extent on who is vested with this function. The way regulatory bodies and their staff are appointed, their qualifications and experience and the rules under which they operate are critical in this respect.

80. When setting up a regulatory body, a few countries have opted for a regulatory body comprised of a single officer, whereas most others have preferred a regulatory commission. A commission may provide greater safeguards against undue influence or lobbying and may limit the risk of rash regulatory decisions. A one-person regulatory body, on the other hand, may be able to reach decisions faster and may be held more accountable. To improve the management of the decision making process in a regulatory commission, the number of members is often kept small (typically three or five members). Even numbers are often avoided to prevent a deadlock, though the chairman could of course have a casting vote.

81. To increase the regulatory body's autonomy, different institutions may be involved in the nomination process; in some countries, regulatory bodies are appointed by the Head of State based on a list submitted by parliament; in others the executive branch of the Government appoints the regulatory body but subject to confirmation by parliament or upon nominations submitted by parliament, users associations or other bodies. Minimal professional qualifications

are often required of regulatory bodies, as well as the absence of conflicts of interest that might disqualify them for the function. Mandates of members of regulatory commissions may be staggered in order to prevent total turnover and appointment of all members by the same administration; staggering also promotes continuity in regulatory decision making. Mandates are often for a fixed term, may be non-renewable and may be terminated before the expiry of the term for limited reasons only (such as crime conviction, mental incapacitation, grave negligence or dereliction of duty). Certain requirements extend to the whole staff of the regulatory entity. Many laws grant a favourable personnel regime, including adequate pay scales, in order to attract qualified candidates and reduce the risk of corruption. Regulatory bodies are often faced with experienced lawyers, accountants and other experts working for the regulated industry and need to be able to acquire the same level of expertise, skills and professionalism, either in-house or by hiring outside advisors as needed. They are often allowed to subcontract certain regulatory tasks short of the ultimate regulatory decision to outside experts.

(g) Budget of the regulatory body

82. Adequate staff and pay-levels, budget for outside expertise and training, and stable funding sources are critical for the success of the regulatory body. In many countries, the budget of the regulatory entity is funded by fees and other levies on the regulated industry. Fees may be set as a percentage of the turnover of the regulated companies, or be levied for the award of licences, concessions or other authorizations. In some countries, the entity's budget is complemented as needed by budget transfers provided in the annual finance law, but this creates an element of uncertainty that may reduce the regulatory body's autonomy.

4. Regulatory process and procedures

83. Any regulatory framework includes procedural rules governing the way the institutions in charge of the various regulatory functions have to exercise their powers.

(a) Disclosure requirements

84. To allow regulatory bodies to carry out their responsibilities, legislation usually imposes specific obligations on regulated industries, including the obligation to provide the regulatory body accurate and timely information on the operations of the company, and grants regulatory bodies specific enforcement rights. They may include enquiries and audits, including detailed performance and compliance audits; sanctions for non-cooperative companies; injunctions or at least initiation of injunctions or penalty procedures to enforce disclosure.

85. Regulated companies are normally required to maintain and disclose their financial accounts and statements and to maintain detailed cost accounting allowing the regulatory body to track various aspects of the company's activities separately. Financial transactions between the company and affiliated companies may also require scrutiny, as companies may try to transfer profits to non-regulated businesses or foreign affiliates. Regulated enterprises may also have detailed technical and performance reporting requirements. However, the regulated enterprises will always be more knowledgeable about their cost structure than regulatory bodies and will only

disclose the information they are effectively required to disclose and in the way that is most favourable to their interests.

86. Fostering competition in the infrastructure sector concerned is one method of dealing with this fundamental asymmetry in information. One of the benefits of introducing competition is that it provides the regulatory body multiple observations and reference points that allow it to determine whether proposals or positions of a regulated company are reasonable and in the public interest. Cost or technical information obtained from competitors may, for example, allow the regulatory body to disallow rate increases based on costs that are higher than the industry norm (see chapter VIII, "Operational phase", ___).

(b) Procedures

87. The credibility of the regulatory process requires transparency and objectivity, irrespective of whether regulatory authority is exercised by a Government department or minister or by an autonomous regulatory body. Rules and procedures should be objective and clear so as to ensure fairness and impartiality. For transparency purposes, the law should require that they be published. Regulatory decisions should state the reasons on which they are based and should be made accessible to interested parties, through publication or other appropriate means.

88. Transparency may be further enhanced, as required by some laws, by the publication by the regulatory body of an annual report on the sector, the decisions taken during the exercise, the disputes that have arisen and the way they were settled, and so on. Such annual report may also include the accounts of the regulatory body and an audit thereof by an independent auditor. Legislation in many countries further requires that this annual report be submitted to a committee of parliament.

89. Regulatory decisions may impact on the interests of diverse groups, including the concerned public service provider, its current or potential competitors, and business or non-business users. In many countries, the regulatory process (whether managed by an agency or a ministry) includes consultation procedures for major decisions or recommendations. In some countries, this consultation takes the form of public hearings, in others of consultation papers on which comments from interested groups are solicited. Some countries have also established consultative bodies comprised of users and other concerned parties and require that their opinion be sought on major decisions and recommendations. To enhance transparency, comments, recommendations or opinions resulting from the consultation process may have to be published or made publicly available.

(c) Dispute settlement

90. The provision of infrastructure services may give rise to a wide range of disagreements or disputes, many of which typically fall within the province of the court system; this would be the case of disputes between public service providers and their suppliers and personnel. The same is true for disputes between public service providers and users, though consumers (or consumer associations) may often, in addition, lodge complaints with the regulatory body. Most major disputes to be settled by the regulatory body are likely to arise between infrastructure service providers, as would be the case with access or interconnection proceedings.

91. Another type of conflict that may arise between the regulated companies and the regulatory body or government concerns the modification of a licence or a tariff formula. These are often dealt with by the regulatory body and may be subject to appeal.

92. In addition, the legislation organizing the sector, investment protection treaties, and licence or contractual provisions often address the right of investors to resort to international commercial arbitration between the Government and the affected entity in case of a perceived breach of contract (see chapter XI, "Settlement of disputes", __).

93. As any of these disputes may have a negative impact on the operations of the concerned company and in view of the public nature of most infrastructure services, many laws (and licence or contract provisions) have developed mechanisms that allow disagreements to be settled promptly without recourse to courts, the regulatory body or arbitration. These may include a technical expertise, audit or certification by an independent third party, as well as permanent conciliation panels or mechanisms.

(d) Sanctions

94. In many countries, the law gives regulatory bodies coercive or punitive powers. Such powers may include the authority to modify, suspend or withdraw a licence, concession or authorization; the right to set the terms of contracts between public service providers (e.g. interconnection or access agreements); to initiate the break-up of a dominant public service provider; to issue injunctions and orders to public service providers; to impose civil penalties including penalties for any delay in implementing the regulatory body's decision, and to initiate criminal or other court procedures.

(e) Appeals

95. Legislators have often provided for appeal procedures against decisions of a regulatory body. The laws of many countries limit the causes that give ground to appeal, however, in order to prevent the regulatory uncertainty that may arise from appeals intended primarily to delay the effect of regulatory decisions. It is therefore desirable to strike a balance between the protection of legitimate rights of the regulated industry and the credibility of the regulatory system. It is often essential that decision be made quickly. For instance a refusal to grant access to a competitor could drive the competitor into bankruptcy if the matter cannot be resolved expeditiously. Where the right to appeal is granted, it should be to a body that has the required skills and expertise to adjudicate the matter. Some laws give public service providers the right to appeal against certain decisions of the regulatory body to the country's competition authority, others to administrative tribunals or judicial courts.

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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

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LEGISLATIVE RECOMMENDATIONS

Appropriate selection method

(1) For the selection of the concessionaire it is advisable to devise a method that promotes competition within structured, formal procedures. Direct negotiations should be reserved for exceptional circumstances (see paras. 15-18).

Prequalification of project consortia

(2) It is advisable to use a prequalification procedure to narrow down the number of proposals with which the awarding authority must deal. Proceedings involving the evaluation of more than a limited number of proposals are generally not suitable for privately financed infrastructure projects (see paras. 19-20).

(3) Where consortia are formed to submit proposals, their members should not be allowed to participate, directly or through subsidiary companies, in more than one consortium (see para. 38).

(4) Where preferences for national candidates or candidates who offer to procure supplies, services and products in the local market are envisaged, they should be applied as a margin of preference at the evaluation phase and announced in the invitation to prequalify (see paras. 39-40).

(5) It may be useful to allow the awarding authority to consider arrangements for compensating prequalified proponents if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them (see paras. 41-42).

(6) No criterion, requirement or procedure with respect to the qualifications of project consortia should be used that has not been set forth in the prequalification documents (see para. 44).

(7) Upon completion of the prequalification phase, the awarding authority should elaborate a short list of the prequalified project consortia which will be subsequently invited to submit proposals. Subsequent changes in the composition of prequalified consortia should require the approval of the awarding authority (see paras. 45-46).

Initial request for proposals

(8) Unless the awarding authority deems it feasible to formulate input or output specifications of the project and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated, it is advisable to structure the proceedings for requesting proposals from qualified proponents in two stages (see paras. 47-49).

(9) The awarding authority should be allowed to convene a meeting of proponents to clarify questions concerning the request for proposals and to engage in negotiations with any proponent concerning any aspect of its proposal (see para. 51).

(10) Following those negotiations, the awarding authority should review and, as appropriate, revise the initial input or output specifications. The awarding authority should be allowed to delete or modify any aspect, originally set forth in the initial request for proposals, of the technical or quality characteristics of the project and any criterion originally set forth in those documents for evaluating and comparing proposals and for ascertaining the successful proponent (see para. 52).

Final request for proposals

(11) At the final stage, the awarding authority should invite the proponents to submit final proposals with price with respect to the revised specifications and contractual terms (see paras. 53-65).

Contents and submission of final proposals

(12) Technical proposals should, as a minimum, include:

(a) specifications and schedule of works;

(b) feasibility and other studies;

(c) description of services to be provided and applicable quality standards;

(d) description of maintenance services and standards (see para. 66).

(13) Financial proposals should, as a minimum, include:

(a) The proposed tariff or price structure;

(b) The proposed duration of the concession, where it is not specified in the request for proposals;

(c) The level of governmental financial support required for the project, including, as appropriate, any subsidy or payment expected from the host Government;

(d) The extent of risks assumed by the concessionaire during the construction and operation phases, including unforeseen events, insurance, equity investment and other guarantees against those risks (see para. 67).

Evaluation criteria

(14) Criteria for the evaluation of the non-price technical aspects of proposals should include technical feasibility; environmental effectiveness; effectiveness of the proposed construction and operation systems; soundness of the proposed financial arrangements, including resources of the proponents (see para. 72).

(15) Criteria for the evaluation of the price proposals should include costs for design and construction activities; annual operation; maintenance costs; present value of capital costs and operating costs; present value of the proposed price over the concession period; the amount of subsidy, if any, expected from the host Government (see para. 73).

Opening, comparison and evaluation of proposals

(16) Upon receipt of the final proposals, the awarding authority should ascertain whether they are *prima facie* responsive to the request for proposals. Incomplete or partial proposals should be rejected at this stage (see para. 75-77).

Final negotiations

(17) The awarding authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the proponent that has attained the best rating. These negotiations should not concern those terms of the contract that were deemed not negotiable in the final request for proposals (see para. 78).

(18) If it becomes apparent to the awarding authority that the negotiations with the proponent invited will not result in a project agreement, the awarding authority should inform that proponent that it is terminating the negotiations and then invite for negotiations the other proponents on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals (see para. 79).

Notice of project award

(19) The awarding authority should cause a notice of the award of the project to be published. The notice should indicate:

(a) The name of the concessionaire;

(b) A list of the annexes and enclosures that form part of the agreement;

(c) A description of the works and services to be performed by the concessionaire;

(d) The duration of the concession;

(e) The tariff structure;

(f) The rights and obligations of the concessionaire and the guarantees assumed or to be provided by it;

(g) The monitoring rights of the awarding authority and remedies for breach of the project agreement;

(h) The obligations of the host Government, including any payment, subsidy or compensation offered by the host Government;

(i) Any other essential term of the project agreement, as provided in the request for proposals (see para. 80).

Circumstances authorizing the use of direct negotiations

(20) Direct negotiations should be resorted to only in exceptional circumstances (see paras. 82-85). Exceptional circumstances may include the following:

(a) When there is an urgent need for ensuring immediate provision of the service, and engaging in a selection procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the awarding authority nor the result of dilatory conduct on its part;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount (see para. 86).

(21) Direct negotiations might be further resorted to when an invitation to prequalify or a request for proposals has been issued but no applications to prequalify or proposals were submitted, or all proposals were rejected by the awarding authority, and when, in the judgement of the awarding authority, issuing a new request for proposals would be unlikely to result in a project award (see para. 87).

Unsolicited proposals

(22) The awarding authority should establish transparent procedures for dealing with unsolicited proposals (see paras. 88-90).

(23) Upon receipt of an unsolicited proposal, the awarding authority should determine whether it might be in the public interest to develop the proposed project. The awarding authority should examine the proposal within a reasonable period. Title to all documentation submitted should vest in the proponent throughout the procedure. If the proposal is rejected, all documents submitted should be returned to the proponent. No proposals should be solicited concerning a rejected project for a minimum number of years without the invitation of the company which submitted the original proposal (see paras. 91-92).

(24) If the host Government accepts the proposal, the awarding authority should engage in a competitive selection procedure (such as request for proposals), preceded by a prequalification phase. The company that submitted the original proposal should be invited to participate in such proceedings and might be given, as a premium for submitting the proposal, a margin of preference over the final rating. If such a margin of preference is given, appropriate notice should be given to all companies invited to submit proposals (see para. 93).

Record of selection proceedings

(25) The law should require that the awarding authority keep appropriate record of key information pertaining to the selection proceedings (see paras. 94-99).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. General remarks

1. This chapter deals with methods and procedures recommended to be used for the award of privately financed infrastructure projects. In line with the advice of international organizations, such as the World Bank 1/ and UNIDO 2/, the *Guide* expresses a clear preference for the use of competitive selection procedures, rather than direct negotiations with project consortia, as further explained in paragraphs 15 to 17 below.

2. The selection procedures recommended in this chapter present some of the features of the tendering method under the UNCITRAL Model Law on Procurement of Goods, Construction and Services 3/ with a number of adaptations so as to take into account the particular needs of privately financed infrastructure projects. The method herein consists of a two stage procedure with a prequalification phase. It allows some scope for negotiations between the awarding authority and the proponents within clearly defined conditions. The description of the procedures recommended for the selection of the concessionaire is primarily concerned with those elements that are special to, or particularly relevant for, privately financed infrastructure projects. Where appropriate, this chapter refers the reader to provisions of the UNCITRAL Model Law, which may *mutatis mutandis* supplement the selection procedure described herein.

B. Selection procedures covered by the *Guide*

3. Private investment in infrastructure may take various forms, each requiring special methods for selecting the concessionaire. For the purpose of discussing possible selection methods for the infrastructure projects dealt with in the *Guide*, a distinction may be made between three main forms of private investment in infrastructure:

(a) *Purchase of public utilities enterprises*. Private capital may be invested in public infrastructure through the purchase of physical assets or the shares of public utility enterprises. Those transactions are often carried out in accordance with rules governing the award of contracts for the disposition of State property. Disposition methods often include

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1/ International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13(a).

2/ *UNIDO BOT Guidelines*, p. 96.

3/ The UNCITRAL Model Law on Procurement of Goods, Construction and Services (hereafter referred to as "the UNCITRAL Model Law") and its accompanying Guide to Enactment, were adopted by the Commission at its twenty-seventh session (New York, 31 May-17 June 1994).

competitive proceedings such as auctions or invitations to bid whereby the property is awarded to the qualified party offering the highest price;

(b) *Provision of public services without development of infrastructure*. In other types of projects, the service providers own and operate all the equipment necessary and sometimes compete with other suppliers for the provision of the relevant service. Some national laws establish special procedures whereby the State may authorize a private entity to supply public services by means of exclusive or non-exclusive "licences". Licences may be publicly offered to interested parties who satisfy the qualification requirements set forth by the law or established by the licensing authority. Sometimes licensing procedures involve public auctions to interested qualified parties;

(c) *Construction and operation of public infrastructure*. In projects for the construction and operation of public infrastructure, a private entity is engaged to provide both works and services to the public. The procedures governing the award of those contracts are in many aspects similar to those that govern public procurement of construction and services. National laws provide a variety of methods for public procurement, ranging from structured competitive methods, such as tendering proceedings, to less structured negotiations with prospective suppliers.

4. This chapter deals primarily with selection procedures suitable to be used for infrastructure projects which involve an obligation, on the part of the selected private entity, to undertake physical construction, repair, or expansion works in the infrastructure concerned with a view to subsequent private operation (i.e. those referred to in paragraph 3(c) above). It does not deal specifically with methods for disposal of State property for privatization purposes or procedures for licensing public service providers.

5. It should be noted, however, that some infrastructure projects may involve elements of more than one of the categories mentioned above, a circumstance which the Government may wish to consider when choosing the selection method. For instance, the acquisition of a privatized public utility (e.g. a water distribution company) may be coupled with an obligation to effect substantial investment in new infrastructure (e.g. expansion of pipe network). In those situations, it is important for the Government to identify the predominant element of the project (e.g. whether privatization or construction of new infrastructure) in order to choose the appropriate selection procedure which the Government might then wish to adjust so as to take into account the main ancillary obligations expected to be assumed by the concessionaire. To that end, some of the considerations set forth in this chapter may also be relevant, *mutatis mutandis*, for the disposal of State property or licensing procedures which involve an obligation on the part of the new concessionaire or licensee to undertake infrastructure works.

C. General objectives of selection procedures

6. For the award of contracts for infrastructure projects, the host Government may either apply methods and procedures already provided in its laws or establish procedures specifically designed for that purpose. In either situation, it is important to ensure that such procedures are

generally conducive to attaining the fundamental objectives of rules governing the award of public contracts. Those objectives are briefly discussed below.

1. Economy and efficiency

7. In connection with infrastructure projects, economy refers to the selection of a concessionaire that is capable of performing works and delivering services of the desired quality at the most advantageous price and upon the most advantageous contractual terms. It is promoted by procedures that provide a favourable climate for participation in the selection process by competent companies and that provide incentives to them to offer their most advantageous terms.

8. In most cases, economy is best achieved by means of procedures that promote competition among project consortia. Competition provides them with incentives to offer their most advantageous terms, and it can encourage them to adopt efficient or innovative technologies or production methods in order to do so. Furthermore, economy can often be promoted through participation by foreign companies in selection proceedings. Not only can foreign participation expand the competitive base, it can also lead to the acquisition by the awarding authority and its country of technologies that are not available locally. Foreign participation in selection proceedings may be necessary where there exists no domestic expertise of the type required by the awarding authority. A country desiring to achieve the benefits of foreign participation should ensure that the relevant laws and procedures are conducive to such participation. It should be noted, however, that competition does not necessarily require the participation of a large number of proponents in a given selection process. Particularly for large projects, there may be reasons for the awarding authority to wish to limit the number of participants to a manageable number (see paras. 19-20). Provided that appropriate procedures are in place, the awarding authority can take advantage of effective competition even where the competitive base is limited.

9. Efficiency refers to selection of a concessionaire within a reasonable amount of time, with minimal administrative burdens and at reasonable cost both to the awarding authority and to participating contractors or suppliers. In addition to the losses that can accrue directly to the awarding authority from inefficient selection procedures (e.g. due to delayed selection or high administrative costs), excessively costly and burdensome procedures can lead to increases in the overall project costs or even discourage competent companies from participating altogether in the selection proceedings.

2. Promotion of integrity of, and confidence in, the selection process

10. Another important objective of rules governing the selection of the concessionaire is to promote the integrity of, and confidence in, the process. Thus, an adequate selection system will usually contain provisions designed to ensure fair treatment of project consortia, to reduce or discourage unintentional or intentional abuses of the selection process by persons administering it or by companies participating in it, and to ensure that selection decisions are taken on a proper basis.

11. Promoting the integrity of the selection process will help to promote public confidence in the process and in the public sector in general. Project consortia will often refrain from spending the time and sometimes substantial sums of money to participate in selection proceedings unless they are confident that they will be treated fairly and that their proposals or offers have a reasonable chance of being accepted. Those that do participate in selection proceedings in which they do not have that confidence have a tendency to increase the project cost to cover the higher risks and costs of participation. Ensuring that selection proceedings are run on a proper basis could reduce or eliminate that tendency and result in more favourable terms to the awarding authority.

3. Transparency of laws and procedures

12. Transparency of laws and procedures governing the selection of the concessionaire will help to achieve various of the policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the awarding authority and by project consortia are fully disclosed, particularly to such participants. Transparent procedures are those which enable the participants to ascertain what procedures have been followed by the awarding authority and the basis of decisions taken by it.

13. One of the most important ways to promote transparency and accountability is to include provisions requiring that the awarding authority maintain a record of the selection proceedings (see paras. 95-99). A record summarizing key information concerning those proceedings facilitates the exercise of the right of aggrieved project consortia to seek review. That in turn will help to ensure that the rules governing the selection proceedings are, to the extent possible, self-policing and self-enforcing. Furthermore, adequate record requirements in the law will facilitate the work of Government bodies exercising an audit or control function and promote the accountability of awarding authorities to the public at large as regards the award of infrastructure projects. A general requirement of record-keeping in procurement proceedings is contained in article 11 of the UNCITRAL Model Law.

14. Transparent laws and procedures create predictability, enabling project consortia to calculate the costs and risks of their participation in selection proceedings and thus to offer their most advantageous terms. They also help to guard against arbitrary or improper actions or decisions by the awarding authority or its officials and thus help to promote confidence in the process. Transparency of laws and procedures is of particular importance where foreign participation is sought, since foreign companies may be unfamiliar with the country's practices for the award of infrastructure projects.

D. Appropriate selection method

15. Generally, economy and efficiency in the award of public contracts are best achieved through methods that promote competition among a range of contractors and suppliers within structured, formal procedures. Competitive selection procedures, such as tendering, are usually prescribed by national laws as the rule for normal circumstances in procurement of goods or construction.

16. In competitive selection procedures, the awarding authority typically invites a range of companies to submit proposals which must be formulated on the basis of technical specifications and contractual terms specified by the awarding authority in the documents made available by it to proponents. Proposals are examined, evaluated and compared and the decision of which proposal to accept is made in accordance with essentially objective criteria and procedures that are set forth in the procurement laws and in the tender documents. Competitive selection procedures are said to be "open" when the awarding authority solicits proposals by means of a widely advertised invitation to tender directed to all companies wishing to participate in the proceedings. The procedures are said to be "restricted" when the awarding authority solicits proposals only from certain companies selected by it.

17. The formal procedures and the objectivity and predictability that characterize the competitive selection procedures generally provide optimal conditions for competition, transparency and efficiency. Thus, the rules for procurement under loans provided by the World Bank require that, for projects financed with loans provided by the World Bank, the concessionaire has to be selected pursuant to competitive procedures acceptable to the World Bank (e.g. "international competitive bidding"). 4/ The use of competitive selection procedures in privately financed infrastructure projects has also been recommended by UNIDO, which has formulated detailed practical guidance on how to structure those procedures. 5/ However, no international legislative model has thus far been specifically devised for competitive selection procedures in privately financed infrastructure projects.

18. National legislative provisions on competitive procedures for the procurement of goods construction or services may not be entirely suitable for privately financed infrastructure projects. International experience in the award of privately financed infrastructure projects has revealed some limitations of traditional forms of competitive selection procedures, such as the tendering method. In the light of the particular issues raised by privately financed infrastructure projects, which are briefly discussed below, it is advisable for the host Government to consider adapting such procedures for the selection of the concessionaire.

1. Range of proponents to be invited

19. In traditional Government procurement, the objective of economy is often maximized by allowing for as wide as possible competition among contractors and suppliers. Invitations to tender are sometimes issued directly without prior prequalification proceedings. Where

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4/ Under the World Bank Rules, a concessionaire selected pursuant to procedures acceptable to the World Bank is generally free to adopt its own procedures for the award of contracts required to implement the project. However, where the concessionaire was not itself selected pursuant to those competitive procedures, the award of subcontracts has to be done pursuant to competitive procedures acceptable to the World Bank (International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13(a)).

5/ *UNIDO BOT Guidelines*, p. 96.

prequalification is required, it is sometimes limited to verifying a number of formal requirements (e.g. the contractors' professional qualification or legal capacity).

20. The award of privately financed infrastructure projects, in turn, typically involves complex, time-consuming and expensive proceedings. Furthermore, the sheer scale of most infrastructure projects reduces the likelihood of obtaining proposals from a large number of suitably qualified project consortia. In addition, competent project consortia may be reluctant to participate in procurement proceedings for high-value projects if the competitive field is too large and where they run the risk of having to compete with unrealistic proposals or proposals submitted by unqualified candidates. Therefore, open tendering without a prequalification phase is usually not advisable for the award of infrastructure projects.

2. Emphasis on output requirements

21. In traditional public procurement of construction works the Government usually assumes the position of a *maître d'ouvrage* or employer, while the selected contractor carries out the function of the performer of the works. The procurement procedures applied by the Government emphasize the inputs to be provided by the contractor, i. e. the awarding authority establishes clearly what is to be built, how and by what means. It is therefore common that invitations to tender for construction works are accompanied by extensive and very detailed specifications of the type of works and services being procured. In those cases, the Government will be responsible for ensuring that the specifications are adequate to the type of infrastructure to be built and that such infrastructure will be capable of being operated efficiently. In some privately financed infrastructure projects, particularly those involving works of moderate complexity or where the infrastructure is owned by the Government or is to be ultimately transferred to it, the Government usually wishes to establish precise specifications for the works to be performed or the technical means for the services to be provided (i. e. the "input" expected from the concessionaire).

22. However, for many privately financed infrastructure projects, the host Government may envisage a different allocation of responsibilities between the public and the private sector. One of the underlying reasons for some Governments to promote private sector participation in infrastructure development is to release themselves from the immediate responsibility for those functions that are capable of being efficiently carried out by the private sector. Instead of assuming the direct responsibility for managing the project, those Governments may prefer to transfer such responsibility to the concessionaire. In those cases, after having established a particular infrastructure need, the Government may prefer to leave to the private sector the responsibility for devising the best solution for meeting such a need. The selection procedure used by the host Government may thus give more emphasis to the output expected from the project (i.e. the services or goods to be provided) rather than to technical details of the works to be performed or means to be used to provide those services. While the host Government remains ultimately accountable to the public for the quality of the works and services, the private sector will bear the risks that might result, for instance, from the inadequacy of the technical solutions used (see paras. 47-49).

3. Evaluation criteria

23. Goods, construction works or services are typically purchased by Governments with funds available under approved budgetary allocations. With the funding sources usually secured, the main objective of the procuring entity is to obtain the best value for the funds it spends. Therefore, in those types of procurement the decisive factor in establishing the winner among the responsive and technically acceptable proposals is often the global price offered for the construction works, which is calculated on the basis of the cost of the works and other costs incurred by the contractor plus a certain margin of profit.

24. Privately financed infrastructure projects, in turn, are typically expected to be financially self-sustainable, in that the development and operational costs are to be recovered from the project's own revenue. This circumstance, compounded with the magnitude of most infrastructure projects, renders the task of evaluating proposals considerably more complex than in more traditional forms of procurement. Therefore, a number of other factors will need to be considered in addition to the construction and operation cost and the price to be paid by the users. For instance, the awarding authority will need to consider carefully the financial and commercial feasibility of the project, the soundness of the financial arrangements proposed by the project consortia and the reliability of the technical solutions used. Such interest exists even where no governmental guarantees or payments are involved, because unfinished projects or projects with large cost over-runs or higher than expected maintenance costs often have a negative impact on the overall availability of needed services and on the public opinion in the host country. Furthermore, given the usually long duration of infrastructure concessions, the awarding authority will need to satisfy itself of the soundness and acceptability of the arrangements proposed for the operational phase and will weigh carefully the service elements of the proposals (see paras. 72-74).

4. Negotiations with proponents

25. Laws and regulations governing tendering proceedings often prohibit negotiations between the awarding authority and the contractors concerning a proposal submitted by them. The rationale for such a strict prohibition, which is also contained in article 35 of the UNCITRAL Model Law, is that negotiations might result in an "auction", in which a proposal offered by one contractor is used to apply pressure on another contractor to offer a lower price or an otherwise more favourable proposal. As a result of that strict prohibition, contractors selected to provide goods or services pursuant to traditional procurement procedures are typically required to sign standard contract documents provided to them during the procurement proceedings. However, given the complexity of infrastructure projects, it is unlikely that the parties could agree on the terms of a draft project agreement without negotiation and adjustments to adapt those terms to the particular needs of the project. Therefore, it may be useful to allow for some negotiation between the awarding authority and the selected project consortium (see paras. 78-79).

E. Preparations for selection proceedings

26. The award of privately financed infrastructure projects is in most cases a complex exercise requiring careful planning and coordination among the offices involved. By ensuring that adequate administrative and personnel support is available to conduct the type of selection proceeding that it has chosen, the host Government plays an essential role in promoting confidence in the selection process.

1. Appointment of the award committee

27. One important preparatory measure is the appointment of the committee that will be responsible for evaluating the proposals and making an award recommendation to the awarding authority. The appointment of qualified and impartial members to the selection committee is not only a requirement for an efficient evaluation of the proposals, but may further foster the confidence of project consortia in the selection process.

2. Feasibility and other studies

28. As already indicated (see "Introduction and background information on privately financed infrastructure projects", para. 94), one of the initial steps taken by the host Government in respect of a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility. The option to develop infrastructure as a privately financed project requires a positive conclusion of the feasibility and financial viability of the project.

29. Prior to starting the proceedings leading to the selection of a prospective concessionaire, it is advisable for the awarding authority to review and, as required, expand those initial studies. In some countries awarding authorities are advised to formulate model projects for reference purposes (typically including a combination of estimated capital investment, operation and maintenance costs) prior to inviting proposals from the private sector. The purpose of such model projects is to demonstrate the viability the commercial operation of the infrastructure and the affordability of the project in terms of total investment cost and cost to the public. They will also provide the awarding authority with a useful tool for comparison and evaluation of proposals. Confidence of project consortia will be promoted by evidence that the technical, economical and financial assumptions of the project, as well as the proposed role of the private sector, have been carefully considered by the host Government.

3. Preparation of documentation

30. Selection proceedings for the award of privately financed infrastructure projects typically require the preparation of extensive documentation by the awarding authority, including project outline, prequalification documents, the request for proposals, instructions for preparing proposals and a draft of the project agreement. The quality and clarity of the

documents distributed by the awarding authority plays a significant role in ensuring an efficient and transparent selection procedure. The awarding authority may need, at this early stage, to retain the services of independent experts or advisors to assist in establishing appropriate qualification and evaluation criteria, defining output specifications (and, if necessary, input specifications) and preparing the documentation to be issued to project consortia.

31. In many countries it is customary for the Government to devise standard contract forms and general conditions of contract that are used in public contracting. In some countries there may be fairly detailed standard contracts for different infrastructure sectors. Where standard contract documents are provided to project consortia during the selection proceedings, the awarding authority may have limited discretion to negotiate the terms of the project agreement with the selected group of project consortia. Standard contract terms may be useful to help expedite the conclusion of the project agreement by limiting the matters on which the parties have to elaborate contractual provisions. They may further be useful for ensuring consistency in the treatment of issues common to most projects in a given sector.

32. However, in using standard contract terms it is advisable to bear in mind the possibility that a specific project may raise issues that had not been anticipated when the standard document was prepared or that the project may necessitate particular solutions that might be at variance with the standard terms. Careful consideration should be given to the need for achieving the appropriate balance between the level of uniformity desired for project agreements of a particular type and the flexibility that might be needed for finding project-specific solutions.

F. Prequalification of project consortia

33. In most privately financed infrastructure projects the host Government may wish to narrow down the number of proposals with which the awarding authority must deal. This result may be achieved by applying a rigorous procedure to limit the number of prospective proponents from whom proposals will be subsequently requested. In addition, prequalification proceedings for privately financed infrastructure projects may involve elements of evaluation and selection, particularly where the awarding authority establishes a ranking of prequalified project consortia. Thus the prequalification of project consortia differs from more traditional prequalification proceedings, such as those used in the procurement of goods or services, where all candidates that meet the prequalification criteria are automatically admitted to the tendering phase.

1. Invitation to prequalify

34. In order to promote transparency and competition, it is advisable that the invitation to prequalify be published in a manner that reaches an audience wide enough to provide an effective level of competition. The laws of many countries identify publications, usually the official gazette or other official publication, in which the invitation to prequalify is to be published. In view of the objective of the UNCITRAL Model Law of fostering participation in procurement proceedings without regard to nationality and maximizing competition, article 24(2) requires publication of the invitations to prequalify also in a language customarily used

in international trade, in a newspaper of wide international circulation or in a relevant trade publication or technical or professional journal of wide international circulation.

35. Prequalification documents should contain sufficient information for project consortia to be able to ascertain whether the works and services entailed by the project are of a type that they can provide and, if so, how they can participate in the selection proceedings. In addition to elements that are usually required to be contained in prequalification documents under general rules on public procurement (e.g. those mentioned in articles 7(3)(i), (iii), (iv) and (v); 25(1)(a) and (d); and 25(2)(a)-(d) of the UNCITRAL Model Law), the invitation to prequalify should identify the infrastructure to be built or renovated and contain information on other essential elements of the project, including the services to be delivered by the concessionaire, the financial arrangements envisaged by the awarding authority (e.g. whether the project will be entirely financed by user fees or tolls or whether public funds may be provided as direct payments, loans or guarantees) and, where already known, a summary of the principal required terms of the project agreement to be entered into as a result of the selection proceedings.

2. Prequalification criteria

36. Generally, project consortia should be required to demonstrate that they possess the professional and technical qualifications, financial and human resources, equipment and other physical facilities, managerial capability, reliability and experience, as necessary to carry out the project (cf. UNCITRAL Model Law, article 6(1)(b)(i)). Qualification requirements should cover all phases of an infrastructure project, including financing management, engineering, construction, operation and maintenance, where appropriate.

37. It is advisable to avoid burdening the law with details concerning qualification requirements and to leave it instead to regulations or to the awarding authority to set forth the type of information to be provided by the project consortia, including, for instance, quality indicators of their past performance as public service providers or infrastructure operators. Such information may relate to the size and type of previous projects carried out by the project consortia; the level of experience of the key personnel to be engaged in the project; sufficient organizational capability, including minimum levels of construction, operation and maintenance equipment. The regulations may set forth in some detail the manner in which the project consortia have to demonstrate their capability to sustain the financing requirements for the engineering, construction and operational phases of the project. The awarding authority may at this stage establish a minimum percentage of equity investment and require that the project consortia indicate the envisaged financing arrangements.

38. Given the large scale of most infrastructure projects, the interested companies typically participate in the selection proceedings through consortia especially formed for that purpose. Therefore, information required from consortium members should relate to the consortium as a whole as well as to its individual participants. For the purpose of facilitating the liaison with the awarding authority, it may be useful to require in the prequalification documents that each consortium should designate one of its members as a focal point for all communications with the awarding authority. It is further advisable for the awarding authority to review carefully

the composition of consortia and their parent companies. It may happen that one company, directly or through subsidiary companies, joins more than one consortium to submit proposals for the same project. Such a situation should not be allowed, since it raises the risk of leakage of information or collusion between competing consortia, thus undermining the credibility of the selection proceedings. It is therefore advisable to provide in the invitation to prequalify that the same company, directly or through subsidiary companies, may not be a member of more than one consortium in the same selection proceedings. A violation of this rule should cause the disqualification of the consortia concerned.

3. Domestic preferences

39. The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to candidates that undertake to use national goods or employ local labour. Such preferential or special treatment is sometimes provided as a material qualification requirement (e.g. a minimum percentage of national participation in the consortium) or as a condition for participating in the selection procedure (e.g. to appoint a local partner as a leader of the project consortium).

40. Where such preferences are established, it is important to weigh the expected advantages against the disadvantage of depriving the awarding authority of the possibility of obtaining better options to meet the national infrastructure needs. It is further important not to allow total insulation from foreign competition so as not to perpetuate lower levels of economy, efficiency and competitiveness of the concerned sectors of national industry. This is the reason why many countries that wish to provide some incentive to national suppliers, while at the same time taking advantage of international competition, do not contemplate a blanket exclusion of foreign participation or restrictive qualification requirements. Domestic preferences may take the form of special evaluation criteria establishing margins of preference for national candidates or candidates who offer to procure supplies, services and products in the local market. The margin of preference technique, which is provided in article 34(4)(d) of the UNCITRAL Model Law, is more transparent than subjective qualification or evaluation criteria. Furthermore, it allows the awarding authority to favour local project consortia that are capable of approaching internationally competitive standards and prices, and it does so without simply excluding foreign competition. Where domestic preferences are envisaged, it is advisable that they be announced in advance, preferably in the invitation to prequalify.

4. Contribution towards costs of participation in selection proceedings

41. In some countries, a high price may be charged for the prequalification documents, while in other countries that price might reflect only the cost of printing the prequalification documents and providing them to the candidates. Expensive prequalification documents may be used as an additional tool to limit the number of candidates. At the same time, however, they add to the already considerable cost of participation in the selection proceedings. The high costs of preparing proposals for infrastructure projects and the relatively high risks that a selection procedure may not lead to a contract award may function as a deterrent for some companies to join in a consortium to submit a proposal, particularly when they are not familiar with the selection procedures applied in the host country.

42. Therefore, some countries authorize the awarding authority to consider arrangements for compensating prequalified proponents if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them after the prequalification phase, when justified in a particular case by the complexity involved and the prospect of significantly improving the quality of the competition. It is advisable that such contribution or compensation, when authorized, be announced at an early stage, preferably in the invitation to prequalify.

5. Prequalification proceedings

43. The awarding authority should respond to any request by a project consortium for clarification of the prequalification documents that is received by the awarding authority within a reasonable time prior to the deadline for the submission of applications to prequalify. The response by the awarding authority should be given within a reasonable time so as to enable the project consortia to make a timely submission of their application to prequalify. The response to any request that might reasonably be expected to be of interest to other project consortia should, without identifying the source of the request, be communicated to all project consortia to which the awarding authority provided the prequalification documents (cf. UNCITRAL Model Law, article 7(4)).

44. Qualification requirements should apply equally to all project consortia. An awarding authority should not impose any criterion, requirement or procedure with respect to the qualifications of project consortia which has not been set forth in the prequalification documents (cf. UNCITRAL Model Law, article 6(3)). When considering the professional and technical qualifications of project consortia, the awarding authority should consider the individual specialization of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

45. In some countries, awarding authorities are encouraged to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (e.g. three or four). For that purpose, those countries apply a quantitative rating system for technical, managerial and financial criteria, taking into account the nature the project. Where such a rating system is to be used, that circumstance should be clearly stated in the prequalification documents.

46. Upon completion of the prequalification phase, the awarding authority usually elaborates a short list of the prequalified project consortia which will be subsequently invited to submit proposals. One practical problem sometimes faced by awarding authorities concerns proposals for changes in the composition of project consortia during the selection proceedings. From the perspective of the awarding authority, it is generally advisable to exercise caution in respect of proposed substitutions of individual members of project consortia after the closing of the prequalification phase. Changes in the composition of consortia may substantially alter the basis on which the prequalified project consortia were short-listed by the awarding authority and may give rise to questions about the integrity of the selection proceedings. As a general

rule, only prequalified project consortia should be allowed to participate in the selection phase, unless the awarding authority can satisfy itself that a new consortium member meets the prequalification criteria to substantially the same extent as the retiring member of the consortium.

G. Procedures for requesting proposals

1. Phases of the procedure

47. Following the prequalification of project consortia, it is advisable for the awarding authority to review its original feasibility study and the definition of the output and performance requirements and consider whether a revision of those requirements is needed in the light of the information obtained during the prequalification proceedings. At this stage, the awarding authority should have already determined whether the project consortia will be asked to formulate proposals on the basis of input or output specifications and whether alternatives to those specifications will be considered. If it is deemed both feasible and desirable for the awarding authority to formulate specifications (whether based on expected input or output) to the necessary degree of precision or finality, the Government may wish to structure the selection process as a single-stage selection procedure and proceed to issue a final request for proposals (see paras. 53-79).

48. However, in some cases it may not be feasible for the awarding authority to formulate its requirement in terms of sufficiently detailed and precise specifications or contractual terms to permit proposals to be formulated, evaluated and compared uniformly on the basis of those specifications and terms. This may be the case, for instance, when the awarding authority has not determined the type of technical and material input that would be suitable for the project in question (e.g. the type of construction material to be used in a bridge) or the exact manner in which to meet a particular need, and therefore is seeking proposals as to various possible solutions to obtain the expected output (e.g. the type of payment and traffic control system for a toll road).

49. In such cases, it might be considered undesirable, from the standpoint of obtaining the best value, for the awarding authority to proceed on the basis of specifications it has drawn up in the absence of discussions and negotiations with project consortia as to the exact capabilities and possible variations of what is being offered. For that purpose, the host Government may wish to divide the selection proceedings into two stages and allow a certain degree of flexibility for discussions and negotiations with project consortia. The first stage of those proceedings should provide an opportunity for the awarding authority to solicit various proposals relating to the technical, quality or other characteristics of the project as well as to the contractual terms. Upon the conclusion of that first stage, the awarding authority should finalize the specifications and, on the basis of those specifications, in the second stage, request final proposals from the project consortia.

2. Initial request for proposals

50. Where the selection procedure is divided in two phases, the initial request for proposals typically calls upon the project consortia to submit proposals relating to broad output specifications and other characteristics of the project as well as to contractual terms.

51. The awarding authority may then convene a meeting of proponents to clarify questions concerning the request for proposals and accompanying documentation. The awarding authority may, in the first stage, engage in negotiations with any proponent concerning any aspect of its proposal. The awarding authority should treat proposals in such a manner as to avoid the disclosure of their contents to competing consortia. Any negotiations need to be confidential, and one party to the negotiations should not reveal to any other person any technical, financial or other information relating to the negotiations without the consent of the other party.

52. Following those negotiations, the awarding authority should review and, as appropriate, revise the initial output specifications. In formulating those revised specifications, the awarding authority should be allowed to delete or modify any aspect of the technical or quality characteristics of the project originally set forth in the request for proposals, and any criterion originally set forth in those documents for evaluating and comparing proposals. Any such deletion, modification or addition should be communicated to project consortia in the invitation to submit final proposals. Project consortia not wishing to submit a final proposal should be allowed to withdraw from the selection proceedings without forfeiting any tender security that they may have been required to provide.

3. Final request for proposals

53. At the final stage, the awarding authority should invite the proponents to submit final proposals with respect to the revised specifications and contractual terms.

(a) Content of request for proposals

54. It might be desirable for the legislative or regulatory texts governing the selection proceedings to contain a listing of the information required to be included in the request for proposals. An indication in those laws or regulations of those requirements is useful to ensure that the request for proposals include the information necessary to provide a basis for enabling the project consortia to submit proposals that meet the needs of the awarding authority and that the awarding authority can compare in an objective and fair manner. Listings of items to be included in the solicitation documents for the procurement of goods and construction and in the request for proposals for services are contained, respectively, in articles 27 and 38 of the UNCITRAL Model Law.

55. One category of items to be contained in the request for proposals concerns instructions for preparing and submitting proposals (cf. UNCITRAL Model Law, article 27(a)). The purpose of including these provisions is to limit the possibility that qualified project consortia would be placed at a disadvantage or even rejected due to lack of clarity as to how the

proposals should be prepared. Instructions for preparing proposals usually cover, as appropriate, items such as the manner and the currency or currencies in which the proposal prices (i. e. the proposed schedule of tolls, fees, unit prices and other charges) are to be formulated and expressed (cf. UNCITRAL Model Law, articles 27(i) and (j) and 38(j) and (k)).

56. The request for proposals should describe the works and services to be performed, including, as appropriate, technical specifications, plans, drawings and designs; the location where the construction is to be effected and the services to be provided; time schedule for the execution of works and provision of services (cf. UNCITRAL Model Law, articles 27(d) and 38(g)). If alternative proposals, including variations to non-mandatory elements of the request for proposals, are admitted, the awarding authority should indicate the manner in which they would be compared and evaluated. Alternative proposals should be rejected if they are not accompanied by a fully responsive proposal.

57. The level of detail provided in the specifications, as well as the appropriate balance between the input and output elements, will be influenced by considerations of issues such as the type and ownership of the infrastructure and the allocation of responsibilities between the public and the private sectors. For the construction of new infrastructure to be permanently owned by the Government and destined to be generally open for public use (e.g. roads, tunnels, bridges), the Government may see a need to have a larger degree of control over the engineering design and technical specifications than in the case of privately-owned facilities generally closed to the public and accessible only to the concessionaire (e.g. a private power plant). It is generally advisable for the awarding authority to bear in mind the long-term needs of the project and to formulate its specifications in a manner that allows it to obtain sufficient information so as to select the project consortium that offer the highest quality of services at the best economic terms. In some countries, awarding authorities have been encouraged to formulate specifications for services in a way that define adequately the output and performance required without being over prescriptive in how that is to be achieved.

58. To the extent the terms of the contractual arrangements are already known by the awarding authority, they should be included in the request for proposals, possibly in the form of a draft of the project agreement. The availability of that information at the earliest possible stage facilitates the project consortia's task of establishing the financial viability of the project, in consultation with prospective lenders and capital providers. In order to establish clearly the scope of negotiations following the evaluation of proposals, the final request for proposals should indicate which are the terms of the project agreement that are deemed not negotiable. A requirement that the final proposals submitted by the project consortia should contain evidence showing the comfort of the project consortium's preferred lenders with the proposed commercial terms and allocation of risks, as outlined in the request for proposals, might play a useful role in resisting pressures to reopen commercial terms at the stage of final negotiations (see para. 78). In some countries, project consortia are required to initial and return to the awarding authority the draft project agreement together with their final proposals as a confirmation of their acceptance of all terms in respect of which they did not propose specific amendments.

59. In addition to the items listed above, a number of other items may be particularly relevant for infrastructure projects. For build-operate-transfer projects, for instance, it is advisable to include information regarding the assets and property to be transferred to the host Government at the end of the concession. Where the host Government is selecting a new concessionaire to operate an existing infrastructure, the request for proposals should also include a description of the assets and property that will be made available to the concessionaire. It is also desirable to indicate in the request for proposals the possible alternative, supplementary or ancillary revenue sources (e.g. concessions for exploitation of existing infrastructure), if any, that may be offered to the successful proponent.

60. Other important items of the request for proposals concern in particular the manner in which the proposals will be evaluated; their disclosure is required to achieve transparency and fairness in the selection proceedings. Particularly important is the disclosure of the criteria to be used by the awarding authority in determining the successful proposal, including any margin of preference and any criteria other than price to be used, and the relative weight of such criteria (cf. UNCITRAL Model Law, articles 27(b) and 38(m)).

61. Further relevant information concerns the manner, place and deadline for the submission of proposals (cf. UNCITRAL Model Law, articles 27(n) and 38(c)); the means by which project consortia may seek clarifications of the request for proposals, and a statement as to whether the awarding authority intends, at this stage, to convene a meeting of project consortia (cf. UNCITRAL Model Law, articles 27(o) and 38(q)); the period of time during which proposals shall be in effect (cf. UNCITRAL Model Law, articles 27(o)); the place, date and time for the opening of proposals; and the procedures to be followed for opening and examining proposals (cf. UNCITRAL Model Law, article 27(q) and (r)).

62. One important aspect to be considered by the awarding authority relates to the relationship between the award of one particular project and the governmental policy pursued for the sector concerned (see chapter II, "Sector structure and regulation"). Where competition is sought, the host Government may be interested in ensuring that the relevant market or sector is not dominated by one enterprise (e.g. that the same company does not operate more than a certain limited number of local telephone companies within a given territory). The host Government may thus wish to retain the possibility of rejecting a particular proposal if it determines that the award of the project to the consortium submitting the proposal might make it possible for a particular company to dominate the relevant market or otherwise distort the competition in the sector concerned. For purposes of transparency, it is desirable for the law to provide that, where the awarding authority reserves the right to reject a proposal on those or similar grounds, adequate notice of that circumstance must be included in the request for proposals.

63. Where the awarding authority further reserves the right to reject all proposals, without incurring liability towards proponents, such as compensation for their costs of preparing and submitting proposals, a statement to that effect should be included in the request for proposals (cf. UNCITRAL Model Law, articles 27(x) and 38(d)).

(b) Clarifications and modifications

64. It is desirable to establish procedures for clarification and modification of the request for proposals in a manner that will foster efficient, fair and successful conduct of selection proceedings. The right of the awarding authority to modify the request for proposals is important in order to enable it to obtain what is required to meet its needs. It is also desirable to authorize the awarding authority, whether on its own initiative or as a result of a request for clarification by a project consortium, to modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals. However, in case of extensive amendments of the request for proposals, the deadline for submission of proposals may need to be extended.

65. Generally, clarifications, together with the questions that gave rise to the clarifications, and modifications must be communicated promptly by the awarding authority to all project consortia to whom the awarding authority provided the request for proposals (cf. UNCITRAL Model Law, article 28(1)). If the awarding authority convenes a meeting of project consortia, it should prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the request for proposals, and its responses to those requests, without identifying the sources of the requests, and send copies to the project consortia.

4. Content and submission of final proposals

66. In view of the complexity of privately financed infrastructure projects and the variety of evaluation criteria usually applied in the award of the project, project consortia are often required to formulate and submit separately their technical and financial proposals. The technical proposals to be submitted by the project consortia should include: specifications and schedule of works; feasibility and other studies; description of services to be provided and applicable quality standards; description of maintenance services and standards.

67. Financial proposals should include: proposed tariff or price structure; proposed duration of the concession, where it is not specified in the request for proposals; level of governmental financial support required for the project, including, as appropriate, any subsidy or payment expected from the awarding authority; the extent of risks assumed by the project consortia during construction and operation phase, including unforeseen events, insurance, equity investment and other guarantees against those risks.

68. Feasibility studies are particularly important in privately financed infrastructure projects. They should substantiate the feasibility and viability of the project and should, for instance, cover the following aspects:

(a) *Commercial viability*: particularly in projects financed on a non-recourse or limited recourse basis, it is essential to establish the need for the project outputs and to evaluate and project such needs over the proposed operational life of the project, including expected demand (e.g. traffic forecasts for roads) and pricing (e.g. tolls);

(b) *Engineering design and operational feasibility*: project consortia should be requested to demonstrate the suitability of the technology they propose, including equipment and processes, to national, local and environmental conditions, the likelihood of achieving the planned performance level and the adequacy of the construction methods and schedules. This study should also define the proposed organization, methods and procedures for operating and maintaining the completed facility;

(c) *Financial viability*: project consortia should be requested to indicate the proposed sources of financing for the construction and operation phases, including debt capital and equity investment. While the loan and other financing agreements in most cases are not executed until after the signing of the project agreement, the project consortia should be required to submit sufficient evidence of the lenders' intention to extend the specified financing to the project company. This study should also indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. Such information should allow the awarding authority to consider the reasonableness and affordability of the proposed fees or prices to be charged by the concessionaire and the potential for subsequent increases in the fees or prices;

(d) *Environmental impact*: this study should identify possible negative or adverse effects on the environment as a consequence of the project and indicate corrective measures that need to be taken.

69. In formal selection proceedings, proposals should be required to be submitted in writing, signed and in sealed envelopes. Proposals received by the awarding authority after the deadline for the submission of proposals should not be opened and should be returned to the project consortium that submitted it (cf. UNCITRAL Model Law, article 30(6)).

5. Tender securities

70. It may be advisable for the laws or regulations governing the selection process to authorize the awarding authority to require the project consortia to post a tender security so as to cover those losses that may result from withdrawal of proposals or failure by the selected project consortium to conclude a project agreement.

71. It is advisable that the request for proposals indicate any requirements of the awarding authority with respect to the issuer and the nature, form, amount and other principal terms of any tender security to be provided by project consortia submitting proposals (cf. UNCITRAL Model Law, art. 27(1)). In order to ensure a fair treatment of all project consortia, requirements that refer directly or indirectly to the conduct by the project consortium submitting the proposal should not relate to conduct other than: withdrawal or modification of the proposal after the deadline for submission of proposals, or before the deadline if so stipulated in the request for proposals; failure to achieve financial closing; failure to sign the project agreement if required by the awarding authority to do so; and failure to provide a required security for the performance of the contract after the proposal has been accepted or to comply with any other condition precedent to signing the project agreement specified in the request for proposals (cf. UNCITRAL Model Law, article 32(1)(f)(i)-(iii)). Safeguards should

be included to ensure that a tender-security requirement is only imposed fairly and for the intended purpose.6/

6. Evaluation criteria

72. Criteria for the evaluation of the non-price technical aspects of proposals should include technical feasibility; environmental effectiveness; effectiveness of the proposed construction and operation systems; soundness of the proposed financial arrangements, including resources of the proponents. The evaluation committee should rate the non-price elements of each proposal in accordance with the predisclosed rating systems for the non-price evaluation criteria and specify in writing the reasons for the rating. Besides criteria relating to the quality of the proposal, additional non-price criteria sometimes used by awarding authorities include the extent of participation by local suppliers and contractors, the economic development potential offered by the proposal, the encouragement of employment, the transfer of technology, the development of managerial, scientific and operational skills. For the purpose of ensuring objectivity and transparency, no weight should be given to prequalification criteria at the evaluation stage.

73. Criteria for the evaluation of the financial proposals should include costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs; present value of the proposed price over the concession period; the amount of subsidy, if any, expected from the host Government. For the awarding authority it is advisable not to limit itself to a comparison of the unit prices offered for the expected output but to consider instead all elements of the financial proposals so as to assess their financial feasibility and the likelihood of subsequent increases in the proposed prices.

74. It is important for the awarding authority to determine the relative weight to be accorded to each such criterion and the manner in which they are to be applied in the evaluation of proposals. To the extent practicable, the non-price criteria applied by the awarding authority should be objective and quantifiable, so as to enable proposals to be evaluated objectively and compared on a common basis. This reduces the scope for discretionary or arbitrary decisions. Regulations governing the selection process might spell out how such factors are to be formulated and applied.

6/ Article 32 of the UNCITRAL Model Law provides certain important safeguards, including, *inter alia*, the requirement that the awarding authority should make no claim to the amount of the tender security, and should promptly return, or procure the return of, the tender security document, after whichever of the following that occurs earliest: (a) the expiry of the tender security; (b) the entry into force of the project agreement and the provision of a security for the performance of the contract, if such a security is required by the request for proposals; (c) the termination of the selection process without the entry into force of a project agreement; or (d) the withdrawal of the proposal prior to the deadline for the submission of proposals, unless the request for proposals stipulates that no such withdrawal is permitted.

7. Opening, comparison and evaluation of proposals

75. For the purpose of ensuring transparency, national laws often prescribe formal procedures for the opening of proposals, usually at a time previously specified in the request for proposals, and require that the project consortia that have submitted proposals, or their representatives, be permitted by the awarding authority to be present at the opening of proposals (cf. UNCITRAL Model Law, article 33). Awarding authorities selecting project consortia for infrastructure projects may wish to structure the evaluation of proposals in two stages, as in the evaluation procedure provided in article 42 of the UNCITRAL Model Law. In an initial stage, the awarding authority typically establishes a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the criteria other than price as set out in the proposals, and rates each technical proposal in accordance with such criteria and the relative weight and manner of application of those criteria as set forth in the request for proposals. The awarding authority then compares the financial proposals that have attained a rating at or above the threshold.

76. When the technical and financial proposals are to be evaluated consecutively, the awarding authority at this stage usually opens only the technical proposals and ascertains whether they are *prima facie* responsive to the request for proposals (e.g. whether they cover all items required to be addressed in the technical proposals). Incomplete or partial proposals should be rejected at this stage. While the awarding authority may ask project consortia for clarifications of their proposals, no change in a matter of substance in the proposal, including changes aimed at making an unresponsive proposal responsive, should be sought, offered or permitted at this stage (cf. UNCITRAL Model Law, article 34(1)(a)).

77. The most advantageous proposal should be the one with the highest combined rating in respect of both price and non-price evaluation criteria. Alternatively, the price proposed for the output (e.g. the water or electricity tariff, the level of tolls) might be the deciding factor for establishing the winning proposal among those that have passed the threshold with respect to quality and technical aspects. In order to promote the transparency of the selection process, and to avoid improper use of non-price evaluation criteria, it is advisable to require the awarding committee to provide a written justification of the reasons for selecting a proposal other than the offering the lowest unit price for the output.

[The Commission may wish to consider the desirability of elaborating further on the evaluation criteria recommended to be used to award privately financed infrastructure projects, particularly as regards the notion of "price" and other criteria used to evaluate financial proposals.]

8. Final negotiations

78. The awarding authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the project consortium that has attained the best rating or, as appropriate, the one that offered the lowest price for the output among those that attained the minimum threshold in respect of technical aspects. One particular problem faced by awarding authorities

is the danger that the negotiations with the best qualified project consortium might lead to pressures to amend, to the detriment of the host Government, the price or risk allocation originally contained in the proposal. Changes in essential elements of the proposal should not be permitted, as they may distort the assumptions on the basis of which the proposals were submitted and rated. Therefore, the negotiations at this stage may not concern those terms of the contract that were deemed not negotiable in the final request for proposals.

79. The awarding authority should inform the remaining responsive project consortia that they may be considered for negotiation if the negotiations with the project consortium with better ratings do not result in a project agreement. If it becomes apparent to the awarding authority that the negotiations with the project consortium invited will not result in a project agreement, the awarding authority should inform that project consortium that it is terminating the negotiations and then invite for negotiations the next project consortium on the basis of its ranking until it arrives at a project agreement or rejects all remaining proposals. To avoid the possibility of abuse and unnecessary delay, the awarding entity should not reopen negotiations with any project consortium with whom they had already been terminated.

9. Notice of project award

80. Project agreements frequently include provisions that are of direct interest for parties other than the awarding authority and the project company, and who might have a legitimate interest in being informed about certain essential elements of the project. This is particularly the case for projects involving the provision of a service directly to the general public. For transparency purposes, it may be advisable to establish procedures for publicizing those terms of the project agreement that may be of public interest. One possible procedure may be to require the awarding authority to publish a notice of the award of the project, indicating, *inter alia*, the following elements: (a) the name of the project company;(b) the annexes and enclosures that form part of the agreement; (c) a description of the works and services to be performed by the project company; (d) the duration of the concession; (e) the tariff structure; (f) the rights and obligations of the project company and the guarantees to be provided by it; (g) the monitoring rights of the awarding authority and remedies for breach of the project agreement; (h) the obligations of the host Government, including any payment, subsidy or compensation offered by the host Government; and (i) any other essential term of the project agreement, as provided in the request for proposals. Where such a system is used, it is important to ensure consistency between the notice of award and the project agreement.

H. Direct negotiations

81. In some countries, concessions of public services have traditionally been regarded as a delegation of a State function and, as such, the delegating authority is not bound to follow the same procedures that govern the award of public contracts. In those countries, concessions may be awarded after direct negotiations between the delegating authority and a concessionaire of its choice. In contrast to the competitive selection procedures, which sometimes may appear to be excessively rigid, selection by negotiation is characterized by a high degree of flexibility as to the procedures involved and discretion on the part of the awarding authority.

Sometimes the only requirement for those negotiations may consist in the previous publication of a notice to interested parties who wish to be invited to those negotiations.

82. In other countries, where tendering is under normal circumstances the rule for the award of public contracts, awarding authorities have been encouraged to resort to direct negotiations whenever possible for the award of privately financed infrastructure projects. The rationale for encouraging negotiations in those countries is that in negotiating with project consortia the Government is not bound by pre-determined requirements or rigid specifications and has more flexibility for taking advantage of innovative or alternative proposals that may be submitted by the participants in the selection proceedings, as well as for changing and adjusting its own requirements in the event that more attractive options for meeting the infrastructure needs are formulated during the negotiations.

83. National laws that deal with selection by negotiation usually establish few rules and procedures governing the process by which the parties negotiate and conclude their contract. However, the laws in some countries provide for selection methods that combine certain basic features of the tendering and negotiation methods. In one of such structured methods of negotiation, which is sometimes referred to as "competitive negotiation", the awarding authority solicits proposals from a limited number of companies believed to have the appropriate qualifications and expertise. It also sets forth general criteria that proposals are requested to meet (e.g. general performance objectives, output specification). The awarding authority identifies the proposals that appear to meet those criteria and engages in discussions with the author of each such proposal in order to refine and improve upon the proposal to the point where it is satisfactory to the awarding authority. The price of each proposal does not enter into those discussions. When the proposals have been finalized, the awarding authority requests the author of each proposal to submit a firm price offer in respect of its proposal. The awarding authority selects the proposal of the company offering the lowest price or lowest evaluated price.

84. Negotiated methods generally afford a high degree of flexibility that some countries may find beneficial to the selection of the concessionaire. However, negotiated methods may have a number of disadvantages that make them less suitable to be used as a principal selection method in a number of countries. Because of the high level of flexibility and discretion afforded to the awarding authority, negotiated methods require highly skilled personnel with sufficient experience in negotiating complex projects. They also require a well structured negotiation team, clear lines of authority and a high level of coordination and cooperation among all the offices involved. Therefore, the use of negotiations for the award of privately financed infrastructure projects may not represent a viable alternative for countries that do not have the tradition of using such methods for the award of large Government contracts. Another disadvantage of negotiated methods is that they may not ensure the level of transparency and objectivity that can be achieved by more structured competitive methods. In some countries there might be concerns that the higher level of discretion in negotiated methods might carry with it a higher risk of abusive or corrupt practices.

1. Circumstances authorizing the use of direct negotiations

85. In countries that generally prescribe the use of the competitive selection procedures as a rule for the award of privately financed infrastructure projects direct negotiations are usually only authorized in exceptional cases. For transparency purposes as well as for ensuring discipline in the award of projects, it might be generally desirable for the law to identify the circumstances that may authorize the use of direct negotiations. They may include the following:

(a) When there is an urgent need for ensuring immediate provision of the service, and engaging in a competitive selection procedure would therefore be impractical, provided that the circumstances giving rise to the urgency were neither foreseeable by the awarding authority nor the result of dilatory conduct on its part;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount.

86. In some countries, after a competitive selection procedure was initiated, situations might arise under which the awarding authority may prefer to change the selection method in favour of direct negotiations. This may be particularly the case when an invitation to prequalify or a request for proposals has been issued but no applications to prequalify or proposals were submitted, or all proposals were rejected by the awarding authority, and when, in the judgement of the awarding authority, issuing a new request for proposals would be unlikely to result in a project award. In such a case, the awarding authority might prefer to enter into negotiations with responsive proponents, as a an alternative to having to reject all proposals and start another procedure with possible uncertain results.

2. Unsolicited proposals

87. Unsolicited proposals may result from the identification by the private sector of a need that may be met by a privately financed infrastructure project. They may also involve innovative proposals for infrastructure management. The host Government may therefore have an interest in stimulating the private sector to formulate innovative proposals for infrastructure development. At the same time, however, the award of projects pursuant to unsolicited proposals and without competition from other project consortia may expose the Government to serious criticism, particularly in cases involving exclusive concessions. Furthermore, in the absence of competition the host Government may deprive itself of objective parameters for comparing prices, technical elements and the overall effectiveness of the project.

88. Two basic approaches may be found for dealing with such unsolicited proposals: in some countries the Government is authorized to negotiate unsolicited proposals directly with the proponent; in other countries projects resulting from unsolicited proposals, too, need to be awarded pursuant to the generally applicable award procedures.

89. One possibility for taking advantage of the potential innovation that may result from unsolicited proposals may be to establish a transparent procedure for dealing with such proposals, such as the procedure described in the following paragraphs.

(a) Submission of initial proposal

90. The company or project consortia who approach the host Government with a suggestion for private infrastructure development may be requested to submit an initial proposal containing the following information: description of the company or companies concerned (references to previous projects, financial information); the project (type of project, location, regional impact, proposed investment, operation costs, financial assessment, resources needed from the host Government or third parties); the site (ownership and whether land or other property will have to be expropriated); a description of the service and the works.

(b) Initial response and formal proposals

91. Following a preliminary examination, the host Government should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project. When the host Government reacts positively to the project, the company should be invited to submit a formal proposal which, in addition to the items covered in the initial proposal, has to contain a technical and economical feasibility study (including characteristics, costs and benefits) and an environmental impact study. The company submitting the unsolicited proposal should retain title to all documents submitted throughout the procedure, and those documents should be returned to it in the event the proposal is rejected. In order not to discourage unsolicited proposals, it is advisable to provide that no proposals may be solicited concerning a rejected project for a certain number of years without the invitation of the company which submitted the original proposal.

(c) Public proposal

92. If the host Government accepts the proposal, the awarding authority should engage in public selection proceedings as described above in paragraphs 43-80, to which the company that submitted the original proposal should be invited. In such proceedings, the original proponent might be given, as a premium for submitting the proposal, a margin of preference over the final rating.

93. In the subsequent proceedings the awarding authority may need to make use of designs, plants and other documents that had been originally submitted with the unsolicited proposal. Thus, it is important to settle at this stage possible questions concerning the intellectual property rights in those designs, plants and documents, in the event that such intellectual property rights have not yet been acquired by the awarding authority. *[The Commission may wish to consider whether this issue should be elaborated further.]*

I. Review procedures

94. An important safeguard of proper adherence to the rules governing the selection procedure is that project consortia have the right to seek review of actions by the awarding authority in violation of those rules. Essential features of a review procedure may be drawn, *mutatis mutandis*, from chapter VI of the UNCITRAL Model Law.

J. Record of selection proceedings

95. In order to ensure transparency and accountability and to facilitate the exercise of the right of aggrieved project consortia to seek review of decisions made by the awarding authority, the law should require that the awarding authority keep an appropriate record of key information pertaining to the selection proceedings.

96. The record to be kept by the awarding authority should firstly contain, *mutatis mutandis*, such general information concerning the selection proceedings as is usually required to be recorded for public procurement (e.g. the information listed in article 11 of the UNCITRAL Model Law), including the following:

(a) A description of the project for which the awarding authority requested proposals;

(b) The names and addresses of the companies participating in project consortia that submitted proposals and the name and address of the members of the project consortium with whom the project agreement is entered into;

(c) Information relative to the qualifications, or lack thereof, of project consortia; a summary of the evaluation and comparison of proposals including the application of any margin of preference;

(d) The price, or the basis for determining the price, and a summary of the other principal terms of the proposals and of the project agreement;

(e) A summary of any requests for clarification of the prequalification documents or the request for proposals, the responses thereto, as well as a summary of any modification of those documents;

(f) If all proposals were rejected, a statement to that effect and the grounds therefor.

97. In addition to the above information, it may be useful to require the awarding authority to include the following information in the record of the selection proceedings:

(a) A summary of the conclusions of the preliminary feasibility studies commissioned by the awarding authority and a summary of the conclusions of the feasibility studies submitted by the qualified proponents;

(b) The list of the prequalified project consortia;

(c) If changes to the composition of the prequalified project consortia are subsequently permitted, a statement of the reasons for authorizing such changes and a finding as to the qualifications of the new members or members admitted to the consortia concerned;

(d) If the awarding authority finds most advantageous a proposal other than the proposal offering the lowest unit price for the expected output, a justification of the reasons for such finding by the awarding committee;

(e) If the negotiations with the consortium that submitted the most advantageous proposal and any subsequent negotiations with remaining responsive consortia did not result in a project agreement, a statement to that effect and of the grounds therefor.

98. For selection proceedings involving direct negotiations (see paras. 81-86) it may be useful to include the following information in the record of the selection proceedings:

(a) A statement of the grounds and circumstances on which the awarding authority relied to justify the direct negotiation;

(b) The name and address of the company or companies invited to those negotiations;

(c) If those negotiations did not result in a project agreement, a statement to that effect and of the grounds therefor.

99. For selections proceedings engaged in as a result of unsolicited proposals (see paras. 87-93) it may be useful to include, in addition to the information the following information in the record of the selection proceedings:

(a) The name and address of the company or companies submitting the unsolicited proposal and a brief description thereof;

(b) A certification by the awarding authority that the unsolicited proposal was found to be of public interest.

[The Commission may wish to consider the usefulness of including a discussion of what kind of information should be available to the public and what information should be reserved for the host Government and the proponents.]

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PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter IV. CONCLUSION AND GENERAL TERMS OF THE PROJECT AGREEMENT

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LEGISLATIVE RECOMMENDATIONS

Legislative approach to the project agreement

(1) It is advisable to limit the legislative provisions on the mutual rights and obligations of the host Government and the project company to those strictly necessary, such as provisions on matters for which prior legislative authorization might be needed, or that might affect the interests of third parties or that relate to essential policy matters (see paras. 2-4).

Conclusion of the project agreement

(2) It is advisable to simplify the procedures for the conclusion of the project agreement and to identify in advance the authority or authorities competent to approve and sign the project agreement on behalf of the host Government (see paras. 5-6).

The project site

(3) Where the land for the project site has to be acquired by the host Government through expropriation, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the most expeditious proceedings available under the laws of the host country (see paras. 8-12)

(4) Easements that might be needed by the project company may be provided in sector-specific legislation (see paras. 13-16).

Exclusivity

(5) It is advisable for the law to leave it for the host Government and the project company to agree on whether the host Government needs to undertake not to facilitate or support the execution of a parallel project that might generate competition to the project company (see paras. 17-21).

Legal status of the concessionaire

(6) The host Government may wish to require that project consortia establish an independent legal entity with a seat in the country. Where deemed to be in the public interest, the law may authorize the host Government to award projects to foreign companies (see paras. 26-27).

(7) It may not be advisable to set forth the legislative requirement of a fixed sum as minimum capital (see paras. 29-30).

(8) The law might require that the activities of the project company be limited to the development and operation of a particular project or projects awarded to the project company.

The law might further require that fundamental changes in the statutes and by-laws of the project company or the transfer of effective control over the project company need to be approved by the host Government (see paras. 31-34).

Assignment of the concession

(9) The project company should not have the right to assign the concession without the consent of the Government. The conditions under which an approval to the assignment of a concession prior to its expiry may be granted may include:

(a) acceptance by the new concessionaire of all obligations under the project agreement;

(b) evidence of the new concessionaire's technical and financial capability as necessary for providing the service (see paras. 35-36).

(10) The concessionaire may be authorized to award subconcessions, subject to prior approval by the host Government (see paras. 37-38).

Security interests

(11) Where the physical assets comprised in the infrastructure are not owned by the project company, it advisable for the law to clarify whether and to what extent the project company may create security interests over those assets (see paras. 40-42).

(12) It is useful for the law to enable the project company to create security over the rights arising out of the project agreement, provided that the enforcement of such security does not affect the obligations of the project company under the agreement (see paras. 43-44).

(13) It is further useful for the law to authorize the creation of security interests over the shares of the project company, subject to the approval of the host Government (see below, para. 45).

Duration

(14) Where it is found desirable to adopt legislative provisions limiting the duration of concessions to a maximum number of years, it is advisable to provide a period sufficiently long to allow the project company to repay its debts and to achieve a reasonable revenue, production or usage level (see paras. 46-47).

NOTES ON LEGISLATIVE RECOMMENDATIONS

A. General considerations

1. The "project agreement" between the Government and the project company is the central document in an infrastructure project. The project agreement defines the scope and purpose of the project, the rights and obligations of the parties; it provides details on the works to be performed by the project company and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services.

1. Legislative approaches

2. Three main approaches have been used by national legislation with regard to the content of the project agreement. The laws of some countries scarcely refer to this type of agreement, while the laws of other countries contain extensive mandatory provisions concerning the content of clauses to be included in the agreement. An intermediate approach is taken by those national laws that list a number of issues to be addressed in the project agreement without regulating in detail the content of its clauses.

3. Legislative provisions on certain essential elements of the project agreement may serve the purpose of establishing at the outset of negotiation a general framework for the allocation of rights and obligations between the parties. They may be intended to provide legislative guidance to the public authorities involved in the preparation of project agreements at different levels of Government (national, provincial or local). Such guidance may be found particularly useful by public authorities lacking experience in the negotiation of project agreements. Some countries may further consider that legislative provisions on certain elements of the project agreement may enhance the Government's negotiating position vis-à-vis the project company. Lastly, legislation may sometimes be required so as to provide the Government with the authority to agree on certain types of provisions.

4. The possible disadvantage of legislative provisions dealing in detail with the rights and obligations of the parties is that they might deprive the Government and the project company of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of a specific project. Therefore, it is advisable to limit the scope of legislative provisions concerning the project agreement to those strictly necessary, such as, for instance, provisions on matters for which prior legislative authorization might be needed or those that might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement is not admitted.

2. Conclusion of the project agreement

5. Privately financed infrastructure projects are typically carried out pursuant to written agreements between the Government and the project company. The negotiation and signature of a written agreement is often expressly required by the law. Some national laws prescribe certain

formalities for the conclusion and entry into force of the project agreement. In some countries the terms of the agreement negotiated between the awarding authority and the selected project consortium may be subject to approval by a higher authority. Sometimes the entry into force of the project agreement is subject to an act of parliament or even the adoption of special legislation.

6. With a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable, in some countries the authority to bind the host Government is delegated in the relevant legislation to designated officials, so that the entry into force of the project agreement occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure might not be feasible, or in which final approvals by another entity would still be required, it would be desirable to consider ways to avoid unnecessary delay. It is important to bear in mind that the risk of the project being frustrated by lack of approval after negotiations have been completed is not one that the project company would be ready to assume. Where approval requirements are perceived as arbitrary or cumbersome, the host Government might be requested to provide sufficient guarantees to the project company and the lenders against such risk. In some countries where those approval requirements exist, Governments have sometimes agreed in the project agreement to compensate the project company for all costs incurred in the event the final approval of a project is withheld for reasons not imputable to the project company.

B. General terms of the project agreement

7. Project agreements are typically lengthy documents that deal extensively with a wide variety of general and project-specific issues. Possible legislative implications of what in national laws appear to be core provisions are discussed in this section.

1. The project site

8. Where a new infrastructure facility is to be built on land owned by the host Government, or an existing infrastructure facility is to be modernized or rehabilitated (such as in "modernize-operate-transfer" or "rehabilitate-operate-transfer" projects), it will normally be for the host Government, as the owner of such land or facility, to make it available to the project company. The host Government may either transfer to the project company title to the land or facilities or retain title thereto, while granting the project company a right to use the land or facilities and build upon it.

9. Both in cases where the infrastructure facility will be transferred back to the host Government or will be permanently owned by the project company, it is advisable that the parties establish the condition of such land and facility at the time it is handed over to the project company. Such determination may reduce disagreements at the time the infrastructure facility is returned to the host Government. Therefore, the project agreement should provide for the inspection, measurement and demarcation of such land and existing facility prior to its being transferred or made available to the project company. Further matters which would be typically

dealt with in the project agreement include procedures for handing over the land or facilities and the submission of required documentation.

10. The situation may become more complex when the land is not already owned by the host Government and needs to be purchased from its owners. In the case of projects that originate from an unsolicited proposal from the private sector (see chapter III, "Selection of the concessionaire", paras. 87-93) or infrastructure facilities of relatively high commercial potential that are not deemed to be a national priority, the host Government might not see a compelling reason for undertaking to acquire the land and make it available to the project company. In most cases, however, the project company may not be in the best position to assume the responsibility for purchasing the land needed for the project. The project company may fear the potential delay and expense involved in negotiations with possibly a large number of individual owners and, as necessary in some parts of the world, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the regularity of the title of individual owners. Therefore, it is typical for the host Government to assume the responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in the project cost as a result of the acquisition of land. The host Government may purchase the required land from its owners or, if necessary, acquire it through expropriation.

11. Where expropriation procedures are required, various preparatory measures may need to be taken to ensure that construction works are not delayed. In countries where the law contemplates more than one type of expropriation proceedings, it may be desirable to provide that all expropriations required for privately financed infrastructure projects be carried out pursuant to the more expeditious of those proceedings, such as the special proceedings that in some countries apply for reasons of compelling public need (see chapter I, "General legislative considerations", paras. 36-37).

12. The right to expropriate private property is usually vested in the Government, but the laws of a number of countries also authorize public utilities or public service providers (e.g. railway companies, electricity authorities, telephone companies) to perform certain actions for the expropriation of private property required for providing or expanding their services to the public. Particularly in those countries where the award of compensation to the owners of the property expropriated is adjudicated in court proceedings, it has been found useful to delegate to the concessionaire the authority to carry out certain acts relating to the expropriation, while the host Government remained responsible for accomplishing those acts that, under the relevant legislation, are conditions precedent to the initiation of expropriation proceedings. Upon expropriation, title to the land is often vested in the host Government, although in some cases the law may authorize the host Government and the project company to agree on a different arrangement, taking into account their respective shares in the cost of expropriating the property.

2. Easements

13. Besides the acquisition of property for the construction of the facility, there might be a need for ensuring the project company's access to such property, in cases where the location of the site of the project is such that access to it requires transit on or through the property of third parties. The nature of the project may also be such that it requires the project company to enter property belonging to third parties (e.g. to place traffic signs on adjacent lands; to install poles or electric transmission lines above third parties' property; to install and maintain transforming and switching equipment; to trim trees that interfere with telephonic lines placed on abutting property). The right to use another person's property for a specific purpose or to do work on it is generally referred to in the *Guide* by the word "easement".

14. Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Except for cases where the required easements affect only a small number of adjacent properties, it is usually not an expeditious or cost-effective solution to leave it to the project company to acquire easements directly from the owners of the properties concerned. Instead it is more frequent that those easements are acquired by the host Government, through expropriation procedures carried out simultaneously with the expropriation of the project site.

15. A somewhat different alternative might be for the law itself to provide the type of easements given to the project company, without necessarily requiring the expropriation of the property to which such easements pertain. Such an approach might be used in respect of sector-specific legislation, where the host Government deems it possible to determine, in advance, certain minimum easements that might be needed by the project company. For instance, a law specific to the power generation sector may lay down the conditions under which the concessionaire obtains a right of cabling for the purpose of placing and operating basic and distribution networks on property belonging to third parties. Such a right may be needed for a number of measures, such as establishing or placing underground and overhead cables, as well as establishing supporting structures and transforming and switching equipment; maintaining, repairing and removing any of those installations; establishing a safety zone along underground or overhead cables; removing obstacles along the wires or encroaching on the safety zone.

16. Under some legal systems, the project company might be under an obligation to pay compensation to the owner, as would have been due in the case of expropriation, should the nature of the easement be such that the use of the property by its owner is substantially hindered.

3. Exclusivity

17. One of the central issues dealt with in project agreements is whether the right to operate the infrastructure or to provide the service is exclusive or whether competing infrastructure will be allowed to operate. Exclusivity may concern the right to provide a service in a particular geographical region (e.g. a communal water distribution company) or embrace the whole territory of the country (e.g. a national railway company); it may relate to the right to supply one

particular type of goods or services to one particular customer (e.g. a power generator being the exclusive regional supplier to a power transmitter and distributor), or to a limited group of customers (e.g. a national long-distance telephone carrier providing connections to local telephone companies).

18. For countries wishing to adopt general enabling legislation on privately financed infrastructure projects, a flexible approach to deal with the issue of exclusivity may be for the law to provide that the Government is authorized to grant exclusive concessions when it is deemed to be in the public interest, such as in cases where the exclusivity is justified for reasons of technical or economical viability. The awarding authority may be required to state the reasons for granting an exclusive concession for each particular case. Such general legislation may be supplemented by sector-specific laws regulating the issue of exclusivity in a manner suitable for each particular sector (see chapter II, "Sector structure and regulation", ___).

19. An additional issue that may be raised in some projects is whether the project company may be given an assurance that no competing infrastructure will be allowed to operate. Some national laws contain provisions whereby the Government undertakes not to facilitate or support the execution of a parallel project that might generate competition to the project company. In some cases, the law contains an undertaking by the Government that it will not alter the terms of such exclusivity to the detriment of the project company without the project company's consent. In other countries, such an undertaking may be implied in general rules applying to concessions or in general principles of administrative law particularly where the relevant activity is or used to be the object of a State monopoly.

20. Provisions of this type may be intended to foster the confidence of project company shareholders and lenders that no parallel competing project will be carried out or that the basic assumptions under which the project was awarded will be respected. However, they may limit the ability of the host Government to deal with changed circumstances as the public interest may require. For instance, the required tariff level to allow profitable exploitation of a toll road may exceed the paying capacity of low-income segments of the public. Thus, the host Government may have an interest in maintaining open to the public a non-toll charging road as an alternative to a new toll road. These arrangements are not unusual for road transportation projects.

21. Therefore, it may be preferable for the law to authorize the host Government and the project company to find a suitable solution in the project agreement, rather than regulating the matter in the same fashion for all projects. The possibility of subsequent changes in the host Government's policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure, could further be dealt with by the parties in the provisions dealing with changes of circumstances (see chapter VIII, "Delays, defects and other failures to perform", ___).

4. Legal status of the concessionaire

22. Project agreements typically contain provisions on the legal status of the concessionaire and deal with the question whether the concessionaire has to be established as an independent legal entity or whether the project may be awarded collectively to a project consortium. Provisions on these matters are often contained in national legislation on privately financed infrastructure projects as well.

23. As understood in business practice, a consortium is a contractual arrangement whereby a group of enterprises undertakes to cooperate in carrying out a project without integrating into an independent legal entity. Consortia have been widely used in the construction industry for the development of large, capital-intensive projects requiring technical expertise in different fields. Consortia are commonly regarded as purely contractual arrangements which do not have a juridical personality of their own. However, there is no uniform legal regime governing consortia. They may fall under different contractual categories provided in national laws and the legal status of consortia as well as the rights and obligations of their members vary in different legal systems.

24. Forming a project consortium may present some advantages, such as more flexibility in dealings among the consortium members and with their business partners than in a separate project company. Avoiding double taxation may also be a reason for choosing not to establish an independent legal entity in the host country, in case there is no bilateral double taxation agreement between the host country and the country or countries where the foreign investors have their residence for taxation purposes. There might also be instances where the host Government would wish to retain the possibility of engaging consortia for infrastructure projects, depending on the scale and nature of the project, or with a view to holding all consortium members jointly liable for the entire project.

25. For those countries that wish to retain such possibility, the law might give the awarding authority the option to award the project to a consortium or to require that a separate legal entity be established by the selected project consortium, depending on the needs of the project. However, a number of issues would need to be addressed in the project agreement, and extensive negotiations and detailed provisions might be required to ensure coordination among members of the consortium, adequate liaison with the host Government, as well as clarifying the extent of responsibilities and liabilities of each of the members of the consortium for the execution of the project.1/

1/ A brief discussion of issues arising out of contracting construction works with a non-integrated group of enterprises is contained in the *UNCITRAL Construction Legal Guide* (chapter II, "Choice of Contracting Approach", paras. 9-16). Some of the issues mentioned therein might also apply, *mutatis mutandis*, to negotiations concerning privately financed infrastructure projects, including the following: how the difficulty of bringing a claim against consortium members from different countries, should a dispute arise, may be

26. More common, however, are legislative provisions requiring that the concessionaire be established as an independent legal entity. From the perspective of the host Government, an independent legal entity facilitates coordination in the execution of the project and may provide a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the consortium members. This aspect may be of particular importance where significant portions of the services or supplies required by the project are to be provided by members of the project consortium. Since a substantial part of the liabilities and obligations of the project company, including long-term ones (project agreement, loan and security agreements, construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated.

27. The host Government may further wish to require that the project company be established under the laws of the country. The host Government may consider that the exercise of its regulatory and monitoring functions in respect of the services provided by the project company might be hindered if the project company were subject to the laws of a foreign jurisdiction. Furthermore, given the public interest in the project company's activities, the host Government may wish that the project company comply with national accounting and publicity provisions (e.g. publication of financial statements; publicity requirements concerning certain corporate acts). However, such a requirement emphasizes the need for the host Government to have adequate company laws in place (see chapter I, "General legislative considerations", paras. 46-49). The ease with which the project company can be established, with due regard to reasonable requirements deemed to be of public interest, may help to avoid unnecessary delay in the implementation of the project.

28. The appropriate time for the establishment of the project company is a matter to be considered in the light of the different interests involved in a typical project. Moved by the interest to start the implementation phase as soon as possible, some host Governments might be inclined to require that the project company be established at the earliest possible stage. However, it should be borne in mind that firm and final commitments by the lenders and other capital providers typically may not be available prior to the final award of the concession, particularly where a separate legal entity is the envisaged vehicle for raising funds for the project, such as in a "project finance" transaction (see "Introduction and background information on privately financed infrastructure projects", paras. 68-71). Therefore, it is generally advisable to

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overcome; how the dispute-settlement clause may be formulated so as to enable any dispute between the host Government and several or all the members of the consortium to be settled in the same arbitral or judicial proceeding; how guarantees to be given by third parties as security for performance and quality guarantees to be given by members of the consortium are to be structured; what ancillary agreements may have to be entered into by the Government; whether there are any mandatory rules of the law governing an agreement with a group of contractors.

require that the project company be established within a reasonably short period after, but not before, the award of the project.

29. Another important issue in connection with the establishment of the project company concerns the equity investment required for the establishment of the project company. The host Government has a legitimate interest in seeking an equity level that ensures a sound financial basis for the project company and guarantees its capability to meet its obligations. Such interest may be satisfied by requiring that the project company be established with a certain minimum capital. In some countries, that issue is dealt with in the law itself, by prescribing a fixed sum or establishing a percentage of the total project cost as the minimum capital of the project company. In other countries, these issues are not addressed in the legislation and are left for the procuring entity to decide, sometimes after negotiations with the selected project consortium.

30. The total investment needed as well as the ideal proportion of debt and equity capital vary from project to project so that it would normally be difficult to establish a fixed sum or percentage that would be adequate for all instances. Thus, it may be undesirable to provide a legislative requirement of a fixed sum as minimum capital for all companies carrying out infrastructure projects in the country. A more flexible approach might be to establish individual requirements taking into account the particular circumstances of each project or type of infrastructure. Where the total expected cost of the project cannot be estimated in advance by the awarding authority, the minimum capital required for the establishment of the project company could be indicated in the solicitation of tenders or request for proposals. Where it is not feasible to estimate in advance the project cost, or in the event the host Government prefers to negotiate the amount or ratio of equity investment offered by the selected project consortium, the awarding authority might prefer to have the flexibility to arrive at an adequate minimum capital in the course of the selection process. In countries where the project is awarded by a formal act of the host Government, such as a decree or notice of award, the required minimum capital of the project company could be indicated in such act.

31. In addition to the question of minimum capital, national laws may contain provisions concerning the form under which the project company has to be organized. Some laws specifically require that the project company be incorporated as a certain type of company, while other laws make no provision on this subject. In cases where it is considered important to specify the form in which the project company is to be established, it is desirable to bear in mind the interest of the consortium members in ensuring that their liability will be limited to the amount of their investment. In order to avoid a subsidiary liability for payment of the project company's debts, its shareholders will normally prefer a corporate form in which their liability is limited to the value of their shares in the company's capital, such as a joint stock company. They would be unwilling to carry out a project that would require them to assume unlimited liability for the project company's debts.

32. Some laws contain provisions concerning the scope of activities of the project company, requiring, for instance, that they be limited to the development and operation of a particular project. Such restrictions might serve the purpose of ensuring the transparency of the project's

accounts and preserving the integrity of its assets, by segregating the assets, proceeds and liabilities of this project from those of other projects or other activities not related to the project. Also, such a requirement may facilitate the assessment of the performance of each project since deficits or profits could not be covered with, or set off against, debts or proceeds from other projects or activities. At the same time, however, the host Government might be interested in reserving the possibility of integrating other projects under a common management, in the event the same project company is awarded a complementary project in a separate selection process.

33. The host Government might also be interested in ensuring that the statutes and by-laws of the project company will adequately reflect the obligations assumed by the company in the project agreement, and that no decision will be made that might hinder the execution of the project. Therefore, the law may provide that changes in the statutes and by-laws of the project company require prior authorization by the host Government. In other countries such a level of control is achieved by requiring the participation of the host Government, as a privileged shareholder, in the project company, with the proviso that certain decisions necessitate the positive vote of the host Government in the shareholders' or board's meeting. In requiring governmental approval for modifications of the statutes and by-laws of the project company or for other corporate decisions, it is desirable to weigh the public interests represented through the State against the need for affording the project company the necessary flexibility for the conduct of its business. The daily management of the project would be impaired if even minor matters concerning the company's internal affairs routinely required prior governmental clearance. One possible solution might be to limit the right of the host Government to object to a proposed amendment to those cases that concern provisions deemed to be of essential importance (e.g. amount of capital, classes of shares and their privileges, liquidation procedures) and which could be identified in the project agreement.

34. The host Government may have a legitimate interest in ensuring that the original members of the project consortium maintain their commitment to the project throughout its duration and that they will not be replaced by entities unknown to the host Government. Thus, the law may provide, in addition to the matters mentioned above, that the transfer of effective control over the project company requires the prior approval of the host Government.

5. Assignment of the concession

35. Concessions are granted in view of the particular qualifications and reliability of the concessionaire and in most legal systems they are not freely transferable. Therefore, national laws frequently prohibit the assignment of the concession without the consent of the Government, which may also be required for a transfer of the right to control the project company. General legislative provisions of this type may promote the confidence of the public in the control being exercised by the Government in respect of the qualifications of infrastructure operators or public service providers.

36. Some countries have found it further useful to mention in the legislation the conditions under which an approval to the transfer of a concession prior to its expiry may be granted, such

as, for example, acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability as necessary for providing the service. General legislative provisions of this type may be supplemented by specific provisions in the project agreement setting forth the scope of those restrictions, as well as the conditions under which the consent of the host Government may be granted.

37. Unlike a full assignment, a subconcession involves the transfer, to another entity, of the responsibility to carry out one particular activity falling under the concession. In cases where the project company is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the project company may wish to engage another entity to carry out some of those activities by way of a subconcession. Where the concession itself is not transferable, there may be obstacles to a subconcession without legislative authorization. Under normal circumstances, however, the host Government would have no compelling reason for excluding altogether the possibility of subconcessions, provided that it can be satisfied of the reliability and the qualifications of the subconcessionaire. It may therefore be desirable for the law to clarify that the concessionaire is authorized to award subconcessions, subject to prior approval by the host Government.

38. Another related issue concerns the method for selecting a subconcessionaire. Some countries have special rules governing the award of contracts by public service providers, and in some countries the law expressly requires the use of tendering proceedings for the award of subconcessions. Rules of this type were often adopted at times where nearly all infrastructure was owned and operated by the State, with little or marginal private sector investment. Their purpose was to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of infrastructure projects implemented by privately-owned entities, there may no longer be a compelling reason or public interest for prescribing to the concessionaire the procedure to be followed for the award of subconcessions.

6. Security interests

39. The financing documents for privately financed infrastructure projects typically include extensive security arrangements. Even in cases where the potential market value of the infrastructure might be less than the cost of the investment, security in form of tangible assets might cover at least part of the sums borrowed by the project company. Security over negotiable instruments, receivables and intangible rights might also be important factors for reducing the lenders' exposure to the project risks and possibly enhancing the terms of the loans. Thus, the project company will normally have an interest in being able to pledge to the lenders all or some of the assets, property and rights that arise out of the concession.

(a) Security over the physical assets

40. Legal obstacles to the creation of security interests over the physical assets comprised in the infrastructure may arise where those assets remain in the property of the State throughout the

project term. If the project company lacks the title to the property it will in many legal systems have no (or only limited) power to encumber such property.

41. However, in some countries the creation of some form of security may be possible, particularly where the project company is granted a leasehold interest or right to use the relevant property. Such security would not attach to the property itself, but to the rights and interests granted to the project company under the project agreement. Furthermore, security interests may also be created where the concession encompasses different types of State property, such as when title to adjacent land (and not only the right to use it) is granted to a railway company in addition to the right to use the public infrastructure.

42. It is advisable that the law expressly clarify the extent to which the project company may create security interests over the physical assets comprised in the infrastructure, for instance by indicating the types of assets in respect of which such security interests may be created or the type of security interests that is permissible. However, the Government will be interested in that security interests created by the project company do not adversely affect the project. Therefore, the law may require the approval of the Government, usually to be reflected in the project agreement, in order for the project company to create such security interests.

(b) Security over intangible assets

43. The right to operate the infrastructure is in most cases not transferable without the consent of the Government, a circumstance which usually precludes the creation of security interests over the concession or licence. However, even if the concession itself may not be pledged, the law in some countries authorizes the project company to create security interests over the rights arising out of the concession or licence or the proceeds therefrom. Those proceeds typically include the tariffs charged to the public for the use of the infrastructure or the price paid by the customers for the goods or services provided by the concessionaire. They may also include the revenue of ancillary concessions. Security of this type is a typical element of the financing arrangements negotiated with the lenders.

44. Security interests in the form of assignments or pledges of the proceeds of the concession do not affect the Government's title to the physical assets of the concession and usually do not raise the same policy concerns that might be raised by mortgages or similar charges. However, since the enforcement of some of such security might lead to situations where creditors substitute for the concessionaire in the exercise of certain rights arising out of the concession agreement, such security interests may affect the Government, the public or the project company's contracting parties or customers. Therefore, it may be useful for the law to provide that, for the purpose of financing the construction or operation of the facility, the project company may, with the consent of the Government, create any form of security over the rights arising from the project agreement, provided that the enforcement of such security does not affect the obligations of the project company under the agreement with regard to the project or its operation.

(c) Security over shares of the project company

45. The establishment of security interests over the shares of the project company raises, in principle, concerns similar to those raised by an assignment of the concession. Where the concession may not be assigned or transferred without the consent of the host Government, the law sometimes prohibits the establishment of liens or other security over the shares of the project company. It should be noted, however, that security over the shares of the project company is a type of security commonly required by lenders in project finance transactions and that general prohibitions on the establishment of such security may unnecessarily limit the project company's ability to raise funding for the project. As with other forms of security, it might therefore be useful for the law to authorize the project company to create such security subject to the host Government's prior approval.

7. Duration

46. The desirable duration of a project agreement may depend on a number of factors, such as the operational life of the facility or the time needed for the project company to repay its debts and amortize the initial investment. Therefore, it might not be feasible for the law to establish a duration period that would be appropriate to all types of projects. However, a number of countries have found it desirable to adopt legislative provisions limiting the duration of infrastructure concessions to a maximum number of years. Some laws provide for a combined system requiring that the project agreement should provide for the expiry of the concession once the debts of the project company have been fully repaid and a certain revenue, production or usage level has been achieved, subject to a maximum limit of a fixed number of years. Where it is found desirable to adopt legislative provisions limiting the duration of concessions to a maximum number of years, the limitation should permit fixing a period sufficiently long to allow the project company to fully repay its debts and to achieve a reasonable profit.

47. With regard to the method for calculating the duration of the concession period, national laws offer different solutions. Some laws expressly include the construction phase, as well as any extension given for reasons of force majeure, as part of the concession period. Other laws, however, expressly provide that the time necessary for the execution of the project is not taken into account when calculating the duration of the concession period. Some laws achieve the same result by providing that the period of concession begins to run upon completion of the construction. The rationale for including the construction period in the total concession period is to encourage the project company to complete the construction works ahead of schedule, so as to benefit from a longer period of exploration of the facility. This element of encouragement is not available in case the law excludes the construction from the overall concession period.

C. Specific terms

48. In addition to the essential provisions discussed in the preceding section, project agreements typically deal with a wide variety of other issues which are discussed in the following

chapters of the Guide, such as the extent of Government support provided to the project (see below chapter V, "Government support"); schedule of works (see chapter VI, "Construction phase"); conditions of operation of the infrastructure, level and quality of services, tariff structure and price adjustment provisions (see chapter VII, "Operational phase"); provisions and remedies in the event of default or breach of the project agreement, provisions dealing with changes of circumstances and unforeseen events, performance guarantees and insurance obligations of the project company (see chapter VIII, "Delays, defects and other failures to perform"); transfer of the facility at the end of the project period, possibility of extension and causes of early termination of the project agreement (see chapter IX, "Duration extension and early termination of the project agreement"); provisions on applicable law and dispute resolution mechanisms (see chapter X, "Governing law" and chapter XI, "Settlement of disputes").

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